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COUNTRY AND REGIONAL EXPERIENCES IN ATTRACTING FOREIGN DIRECT INVESTMENT FOR DEVELOPMENT

Foreign direct investment to the least developed countries and other developing countries outside Africa**

Report by the UNCTAD secretariat

SUMMARY

Contrary to the decline of world foreign-direct-investment flows of past years, flows to all developing countries continued to rise, reaching a high share of 31 per cent in world flows in 1992. The only group of developing countries that did not participate in this growth is the least developed countries. As a result, their importance relative to the developing-country total declined from 1.4 per cent during 1981-1985 to 0.6 per cent in 1992, and to the world total from 0.4 per cent to 0.2 per cent.

South, East and South-East Asia continued to be the largest host developing-country region, accounting for 61 per cent of the developing-country total in 1992. China, in particular, attracted considerable amounts of foreign-direct-investment flows, becoming the largest host developing country. Inflows to the Asian newly industrialized economies were maintained at a high level, but are undergoing a restructuring in the direction of higher quality foreign direct investment. Foreign-direct-investment inflows to Latin America have also increased since the late 1980s, and their annual average

* E/C.10/1994/1.

** See also "Foreign direct investment in Africa", E/C.10/1994/5.

amounts during 1991-1992 were more than twice as large as those in the first half of the 1980s. The importance of subsidized foreign-direct-investment flows is declining, and the challenge is now to ensure that conventional flows can be maintained at a sufficiently high level to sustain recent growth rates in investment flows. Further progress in economic integration would be helpful in this regard. Prospects are good that the current level of flows to the developing countries as a whole will be maintained, if not improved, during the 1990s.

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INTRODUCTION

1. In its resolution 1993/49, paragraph 8, the Economic and Social Council requested the Secretary-General to submit to the Commission on Transnational Corporations at its twentieth session a report on the flows of foreign direct investment to least developed countries and other developing countries. In response to this request, the Programme on Transnational Corporations prepared the present report, in cooperation with the ECLAC/UNCTAD Joint Unit. Beginning with a review of foreign direct investment in the least developed countries, the report turns to an analysis of current trends and patterns of investment flows to Asia and Latin America and the Caribbean. A separate report on foreign direct investment in Africa (E/C.10/1994/5) is also before the Commission.

I. FOREIGN DIRECT INVESTMENT IN LEAST DEVELOPED COUNTRIES

2. Least developed countries 1/ received very few of the investment flows that rose rapidly in the developing world beginning with the mid-1980s. Their share of foreign-direct-investment inflows to developing countries remained not only very small but declined from an annual average of 2.2 per cent during 1986-1990 to 0.9 per cent in 1991 and 0.6 per cent in 1992. Their share of total foreign direct investment in the world was even smaller: 0.2 per cent in 1992 (table 1). In absolute terms, the roughly \$0.3 billion of total inflows to all least developed countries in 1992 was about equivalent to the inflows to Pakistan that year.

3. Factors that have discouraged investment inflows to least developed countries have included, generally speaking, the falling global demand for most of their primary exports, coupled often with high levels of external indebtedness; their persistently small domestic investment and slow economic growth (table 2); their small domestic markets; their poorly developed physical infrastructure, including oftentimes difficult and expensive transport and communication links with the outside world; 2/ and a generally unskilled labour force. In a substantial number of least developed countries, political instability and, in some instances, violence and civil strife have become prohibitive deterrents to foreign direct investment. While a number of least developed countries have embarked upon significant structural reforms and liberalized their foreign-direct-investment regulations, 3/ such measures, though necessary and helpful, have not yet proved sufficient inducements for transnational corporations to increase their investments in the group of least developed countries as a whole. The challenge for these countries to attract investment inflows is all the greater because all countries, developed and developing alike, are competing for a larger share of foreign direct investment.

4. This perception is partly offset by locational and other advantages of a number of least developed countries. Least developed countries in Asia, in particular, are well positioned to capture a share of the substantial investment flows that are concentrated in that region. As a number of former foreign-direct-investment inflow leaders among Asian developing countries are graduating

Table 1. Foreign-direct-investment inflows in least developed countries and developing countries, 1981-1992

	1981-1985	1986-1990		
	(Annual average)		1991	1992
<u>Least developed countries</u>				
Total (billions of dollars)	0.2	0.5	0.3	0.3
Share of world total (per cent)	0.4	0.4	0.2	0.2
Share of developing-country total (per cent)	1.4	2.2	0.9	0.6
<u>Developing countries a/</u>				
Total (billions of dollars)	13.1	24.9	39.4	46.8
Share of world total (per cent)	26.3	16.2	24.4	30.8
Total without least developed countries (billions of dollars)	12.9	24.4	39.1	46.5
<u>Africa</u>				
Total (billions of dollars)	1.7	2.9	2.7	3.0
Share of developing-country total (per cent)	12.8	11.4	6.8	6.4
Total without least developed countries (billions of dollars)	1.5	2.4	2.4	2.8
<u>Latin America and the Caribbean</u>				
Total b/ (billions of dollars)	5.8	7.6	14.9	14.5
Share of developing-country total (per cent)	44.7	30.7	37.8	31.0
Total without least developed countries (billions of dollars)	5.8	7.6	14.9	14.5
<u>Middle East</u>				
Total (billions of dollars)	0.4	0.4	0.5	0.3
Share of developing-country total (per cent)	3.4	1.8	1.3	0.5
Total without least developed countries (billions of dollars)	0.4	0.4	0.4	0.1

	1981-1985	1986-1990		
	(Annual average)		1991	1992
<u>South, East and South-East Asia</u>				
Total (billions of dollars)	4.9	13.7	20.8	28.3
Share of developing-country total (per cent)	37.7	55.0	52.7	60.6
Total without least developed countries (billions of dollars)	4.9	13.7	20.7	28.3

Source: UNCTAD Programme on Transnational Corporations, based on International Monetary Fund balance-of-payment tape, retrieved on 13 December 1993, data from the UNCTAD Programme on Transnational Corporations foreign-direct-investment database and the OECD secretariat.

a/ Includes developing countries in Europe (Gibraltar, Malta and former Yugoslavia).

b/ The differences in total figures between this table and table 8 are mainly due to the inclusion of Bermuda here. Data for Bermuda for 1992 are not available.

Table 2. Macroeconomic indicators and foreign-direct-investment inflows in developing countries, 1986-1993

(Percentage)

Item	Least developed countries	Developing countries					World
		Total	Africa g/	Latin America	Middle East b/	South, East and South-East Asia	
Growth rate of foreign direct investment							
1986-1990 (average)	.. g/	21.0	7.4	15.7	21.4	35.9	32.6
1991	-52.7	24.3	18.3	73.6	-1.9	4.9	-21.3
1992	-15.3	18.7	12.5	-2.6	-50.0	36.5	-6.0
1993	..	..	..	..	..	..	..
Growth rate of gross domestic product							
1986-1990 (average)	2.1	4.7	2.5	2.0	3.4	7.1	3.6
1991	0.6	4.5	1.6	3.3	2.4	6.1	0.6
1992	0.4	5.8	0.4	2.5	7.8	7.8	1.7
1993 g/	..	6.1	1.6	3.4	3.4	8.7	2.2
Export growth rate g/							
1986-1990 (average)	2.7	11.4	3.7	5.0	7.6	13.1	6.1
1991	0.4	8.1	1.9	4.7	3.1	11.9	2.4
1992	0.1	9.5	2.1	8.5	8.4	11.2	4.6
1993 g/	3.6	9.4	0.1	4.1	6.9	12.7	3.0
Ratio of external debt to gross domestic product							
1986-1990 (average)	68.7	35.3	59.7	48.9	29.8	24.2	..
1991	55.2	32.3	58.9	43.6	24.0	24.9	..
1992	50.5	28.6	56.1	37.3	19.9	23.8	..
1993 g/	48.1	27.2	56.0	37.5	16.8	24.2	..
Gross fixed capital formation as percentage of gross domestic product							
1986-1990 (average)	16.1	24.2	20.9	19.7	21.8	29.3	..
1991	15.1	24.8	20.8	20.8	23.9	29.0	2.0
1992 g/	15.4	25.0	20.9	21.2	23.8	29.3	3.0
1993	..	..	..	..	..	..	..

Sources: UNCTAD Programme on Transnational Corporations, based on International Monetary Fund, balance-of-payments tape, retrieved on 13 December 1993, and data from the OECD Secretariat; International Monetary Fund, *World Economic Outlook* (Washington, D.C., IMF, 1992 and 1993); UNCTAD, *The Least Developed Countries 1992 Report* (United Nations publication, Sales No. E.93.IID.3).

g/ Egypt and the Libyan Arab Jamahiriya are included in Middle East except for the item on foreign direct investment.

b/ Includes developing countries in Europe (Cyprus, Malta and Turkey) except for the item on foreign direct investment.

g/ Due to negative inflows in 1986, growth rates cannot be calculated. Excluding the 1986 and 1987 data, the average growth rate was 24 per cent.

g/ Projection by the International Monetary Fund.

g/ Volume of merchandise exports. Data for least developed countries are estimated.

to higher value-added activities, some least developed countries in Asia stand to inherit labour-intensive forms of foreign direct investment at the low end of the value-added chain where low-cost labour is a comparative advantage. Bangladesh and perhaps Cambodia fall into this category. In relation to the Caribbean Basin Initiative and its proximity to the North American market, Haiti has the potential to achieve a similar role with respect to foreign direct investment sourcing. Other least developed countries will continue to play an important role as sources of raw materials important to nearby developed and industrializing markets, such as Myanmar with respect to East Asia. Yet other least developed countries have a potential for attracting foreign direct investment in certain niche areas of international demand, such as tourism in the cases of the Maldives, Nepal and the United Republic of Tanzania. In that connection, to the extent that such countries are successful in attracting additional investment inflows through their liberalization of pertinent regulations and effective promotional campaigns, even limited additional inflows could prove substantial, given their small economic base.

5. Among the developing country regions, Africa has the largest concentration of the least developed countries (31 out of 47). They account for 80 to 90 per cent of the total foreign-direct-investment flows to these countries. Changes in flows to the African least developed countries therefore largely determine the behaviour of investment flows to this entire group of countries. Neither the least developed countries as a group nor African least developed countries have participated in the investment boom to developing countries that began in the late 1980s and continues into the 1990s. In the second half of the 1980s, it looked as if these countries could break out from the period of falling foreign direct investment: between 1985 and 1990, flows grew from \$209 million to \$355 million. 4/ The early 1990s brought, however, a contraction of flows to \$254 million in 1991. Flows during the period 1980-1992 never returned to their highest level, reached in 1980, that is, \$444 million. 5/ Within the group of African least developed countries, inflows are highly concentrated: five countries absorbed close to or over 90 per cent of the annual inflows in some years (table 3). The table illustrates the rapidly changing fortunes as regards investment inflows: only Botswana and Zambia were consistently on the list of the largest host countries in all years, while the other large host countries during the early 1990s differed from that during the early 1980s. In addition, inflows in 1991 were such that countries leading the list that year would have hardly made it to the list in 1980. However, a number of least developed countries in Africa occasionally receive amounts of foreign direct investment which, though small in absolute size, are very large when related to the size of their host economies. For example, with annual average flows of \$31 million in 1991-1992, Equatorial Guinea led the list of the largest host countries in Africa as a whole, ranked by the share of foreign-direct-investment inflows in gross domestic product. 6/ Botswana, also an important host country by both relative and absolute measures, is an example of a country with a relationship with transnational corporations that benefited its long-term economic growth. 7/

Table 3. The five largest host countries among African least developed countries, based on foreign-direct-investment inflows, 1980, 1985, 1990 and 1991

(Millions of dollars)

1980		1985		1990		1991	
Botswana	112	Zaire	69	Zambia	203	Botswana	45
Zaire	110	Botswana	54	Botswana	38	Equatorial Guinea	42
Zambia	62	Zambia	52	Sierra Leone	32	Zambia	34
Niger	49	Togo	17	Madagascar	22	Sierra Leone	30
Togo	42	Rwanda	15	Lesotho	17	Mozambique	23
The share in Africa's least developed-country total <u>a/</u> (per cent)							
85		99		88		68	

Source: UNCTAD Programme on Transnational Corporations, based on International Monetary Fund, balance-of-payments tape, retrieved on 13 December 1993.

a/ Excludes Liberia.

6. A number of least developed countries in Africa hardly receive any foreign direct investment at all. But there is also another group in between the non-receivers and the largest host countries. Countries belonging to this group have not attracted recently meaningful amounts of investment, and their flows in the past fluctuated widely between disinvestments in some years and not negligible amounts of flows in other years. But the fact that they are able to attract such amounts, though only for a short period of time, suggests that they are within the purview of foreign investors; the challenge for them is to sustain the attention of foreign investors. The list of these countries, ranked by the highest inflows in any one of the years between 1980 and 1992, is contained in table 4.

Table 4. Highest amounts of foreign direct investment attracted by individual African least developed countries during the period 1980-1992

(Millions of dollars)

Country	Amount	Year
Somalia	64	1987
Mauritania	27	1980
Malawi	25	1987
Lesotho	21	1988
Rwanda	21	1988
United Republic of Tanzania	19	1981
Gambia	15	1989
Benin	13	1991
Burundi	11	1981

Source: UNCTAD Programme on Transnational Corporations, based on International Monetary Fund, balance-of-payments tape, retrieved on 13 December 1993.

7. The least developed countries in Asia seem to be faring better than countries in other regions: their flows increased during the early 1990s, compared to the second half of the 1980s, except for Afghanistan. Among those which have adopted market-oriented economic policies recently, the Lao People's Democratic Republic and Myanmar attracted some investments (table 5). Inflows of foreign direct investment to the Lao People's Democratic Republic between 1989 (when foreign-direct-investment projects started for the first time) and 1992 totalled \$27 million. In this country, 102 permits were granted to foreign investors (mostly from Thailand) in 1992 and 79 in the first half of 1993, mainly in services (including banking). 8/ Myanmar is also beginning to attract some investment, as compared from the 1980s when it received virtually none. Major investors are Thailand, the United States, Singapore and Hong Kong. Flows of foreign direct investment to the Solomon Islands and Vanuatu have been the largest. Given the small size of these countries, these flows are very large relative to the size of their economies (table 5).

Table 5. Foreign direct investment and some economic indicators in selected least developed countries in Asia and Latin America and the Caribbean

Least developed countries	Foreign direct investment			Per capita foreign direct investment 1991-1992 ^{a/} (Dollars)	Foreign direct investment as percentage of gross domestic product 1991-1992 ^{b/}	Per capita gross domestic product 1990 (Dollars)	Per capita gross domestic product growth rate 1989-1990
	1981-1985 (Annual average, million dollars)	1986-1990	1991-1992				
Afghanistan	0.06	0.08	-0.3 ^{c/}	-0.02	-	485	-8.4
Bangladesh	-0.04	2.16	2.55	0.02	0.01	200	3.7
Haiti	6.64	7.44	10.8	1.66	0.44	380	-3.2
Laos People's Democratic Republic	-	2	8.5	2.02	5.4	206	3.3
Maldives	-0.32	4.04	6.55	32.75	0.01	605	11.2
Myanmar ^{d/}	0.08	0.7	1.7	0.04	0.1	548	1.8
Nepal	0.12	1.94	3.1	0.16	0.98	159	1.0
Samoa	0.06	1.40	4.1	20.5	2.9	697	-5.7
Solomon Islands	0.9	5.88	15.35	51.17	11.5	446 ^{d/}	4.1
Vanuatu	5.78	9.62	15.25	76.25	7.6	999	1.8
Yemen	21.94	8.82	4.4 ^{c/}	0.38	0.06	782	-
All least developed countries	181	539	318	0.59	0.19	311	1.5
All developing countries	13 083	24 942	43 105	15.2	1.58	964	0.5

Source: same as in table 1; United Nations Conference on Trade and Development, The Least Developed Countries 1992 Report (United Nations publication, Sales No. E.93.II.D.3), tables 1, 2 and 7, pp. A-3 - A-5 and A-12.

^{a/} Average foreign-direct-investment flows during 1991-1992 divided by population in 1990.

^{b/} Average foreign-direct-investment flows during 1991-1992 divided by gross domestic product in 1990.

^{c/} 1991 only.

^{d/} On an approval basis, cumulative inflows of foreign direct investment reported by the Government were \$1,008 million between the end of 1988 (when the foreign-direct-investment law was promulgated) and 1993; see Nipon Keizai Shimbun, 1 February 1994.

^{e/} 1989.

8. Manufacturing has become an increasingly important sector of foreign direct investment in a number of Asian least developed countries. Bangladesh leads in this respect in terms of having the highest percentage of total exports being manufacturing exports; i.e., about three quarters of the total. The corresponding foreign direct investment has also been in the manufacturing sector, in particular textile industry (box) Nepal has also received foreign direct investment for the production of manufactures, especially textiles, which with other manufactures, such as rugs, account for nearly two thirds of that country's exports. 9/ Foreign direct investment in Nepal, however, has also concentrated on the tourism industry, with significant multiplier effects for the economy in terms of the sale of locally manufactured products and the provision of other services. The Maldives is a third country that has also received investment in industrial production (which accounts for one third of its exports) and especially for the development of tourist hotels and resorts. 10/ Another country that has received substantial foreign direct investment in industry, especially for the production of toys and sporting goods, has been Haiti, the only least developed country in the Western Hemisphere. Given the inducements of the Caribbean Basin Initiative and the attraction of a low-paid labour force, foreign direct investment has played a substantial role in that country's economy, in which three quarters of all exports are manufactures. 11/

9. The least developed countries, as all other developing countries, are trying to attract foreign direct investment to their economies, seeing in this investment a potential support for development. In doing so, they encounter many difficulties. Most of these difficulties are related to their low level of development. The continuing inflow of official development assistance will be essential to overcome them. However, many of these countries have locational advantages, which, if coupled with political and economic stability and friendly policies towards domestic and foreign companies, can attract some foreign direct investment. These advantages include natural resources, touristic attractions and a low-cost labour force. In addition to overall foreign-direct-investment liberalization measures, which are necessary, although not a sufficient ingredient of a good investment climate, targeting specific industries or even firms interested in matching their interests with the locational advantages of least developed countries might be a possibility that could be explored, apart from general promotional efforts. Transnational corporations from other, middle-income developing countries should not be left out of such efforts: as the following sections will show, they are becoming a source of foreign direct investment to the regions in which they are located.

BOX . Foreign direct investment in Bangladesh

Bangladesh presents an interesting case of a least developed country that has been successful in obtaining a growing share of investment flows. Rising labour costs and skills have led to the graduation of a number of other Asian countries to higher value-added activities. As a result labour-intensive activities are migrating from them to countries like Bangladesh. On an approval basis a stock of foreign direct investment was 871 million taka (\$22 million) as of August 1992, not including export-processing zones.^{a/} Investment flows to Bangladesh amounted to \$3.7 million in 1992, up from \$1.4 million in 1991.

Foreign investors have been attracted to Bangladesh's manufacturing sector by both the country's low wages and, in particular, because of that country's unused quota for exporting textiles and apparel to the markets of the European Union and the United States. With garment exports rising from virtually nil in the 1970s to 40 per cent of Bangladesh' export earnings by the end of the 1980s, foreign investment in this industry accounted for nearly one fifth of approved investment inflows in 1992, exclusive of export-processing zones. This industry was initiated in 1979 through a collaborative agreement between Dosh Garment Company, a local Bangladesh firm, and Daewoo Corporation, a transnational corporation based in the Republic of Korea which provided labour training, start-up assistance and overall supervision of production and marketing. ^{b/}

Aside from the textile and apparel industry, foreign direct investment in Bangladesh has been important in the food processing (20 per cent of cumulative approved investment by mid-1992), electric machinery (14 per cent) and chemical (13 per cent) industries. These investments, as with investments in textiles and apparel, tend to be concentrated at the low end of the value-added chain. Investors have been mainly from other Asian developing countries, accounting for more than three quarters of approved investments between mid-1990 and mid-1992. Firms from the Republic of Korea have in particular dominated investment in the export-processing zones, employing three times as many workers as Japanese firms (6,000 workers versus 2,000 workers) and exporting \$4.3 million a month in 1992, compared to \$2.3 million of exports by Japanese affiliates.^{c/}

^{a/} Stock data are not available for foreign direct investment including export-processing zones.

^{b/} For details, see United Nations, Transnational Corporations and Management Division, World Investment Report 1992: Transnational Corporations as Engines of Growth (United Nations publication, Sales No. E.92.II.A.19), pp. 214-215.

^{c/} Japan External Trade Organization, JETRO Hakusho: Toshien, 1993 (Tokyo, JETRO, 1993), pp. 234-237.

II. ASIA AND THE PACIFIC

A. Net resource flows

10. Recent increases in long-term net resource flows to developing countries as a whole reflect the slow-down in developed-country economies and better economic performance and prospects in developing countries, and especially in the countries of South, East and South-East Asia, where these flows have been dramatically increasing since the late 1980s. ^{12/} As a result, this region accounted for 39 per cent of all flows to developing countries in 1992, compared to 33 per cent in 1986. ^{13/} These increases reflect not only the highest economic growth rates in the world (table 2), but also good access to international capital markets as well as the development of local capital markets. China has become the single largest recipient among developing countries, attracting in 1993 more than one third of resource flows to South, East and South-East Asia and some 15 per cent of flows to all developing countries. Net resource flows to China represent now 6 per cent of its gross national product. ^{14/}

11. Foreign direct investment and portfolio investment have become the largest and most dynamic components of these flows. ^{15/} For the region as a whole, the share of foreign direct investment in all resource flows increased from 27 per cent during 1986-1990 to 34 per cent in 1992 (table 6); that of portfolio investment rose from 8 per cent to 13 per cent. The significance of these two types of flows varies, however, among subregions. In South Asia, which accounted for only 15 per cent of resource inflows to the region in 1992, official lending and grants are the most important instruments in external financing, accounting, on average, for 51 per cent and 32 per cent, respectively, of the total resource flows during 1986-1992, as this subregion did not attract substantial private flows. In East and South-East Asia, however, private resource flows accounted for 71 per cent of all resource flows in 1992.

12. The rapidly growing foreign-direct-investment and portfolio-investment flows hold much promise for the region, the needs of which for external financing are enormous: it has been estimated that South and South-East Asia alone will need more than \$1 trillion to finance infrastructure projects and capital-intensive industries over the next decade. ^{16/} To satisfy needs of this magnitude the countries of the region are increasingly using international and local capital markets. In the Eurobond market alone, Asian firms (excluding Japanese ones) issued bonds worth \$14.7 billion in 1993, more than six times the 1992 volume. ^{17/} Major issuers were firms from the Republic of Korea. Firms from India, Malaysia, Pakistan and Thailand are also using this market increasingly.

Table 6. South, East and South-East Asia: net resource flows, by type, 1986-1993 ^{a/}

(Billions of dollars)

Type of flow	1986-1990	1991	1992	1993 ^{b/}
	(Annual average)			
Foreign direct investment ^{c/}	7.5	14.5	21.1	26.1
Portfolio investment	2.2	4.3	8.1	..
Bonds	0.8	3.2	3.4	..
Equity ^{d/}	1.3	1.1	4.7	4.5
Loans	12.9	21.1	26.0	..
Official	10.1	12.1	11.0	14.1
Commercial banks ^{e/}	1.9	6.4	7.7	..
Other private	0.9	2.5	7.3	..
Grants ^{f/}	4.9	5.7	6.7	7.0
Total	27.5	45.5	61.8	72.3

Source: The World Bank, World Debt Tables 1993-94: External Finance for Developing Countries, Volume 1. Analysis and Summary Tables (Washington, D.C., The World Bank, 1993), pp. 178-181.

^{a/} Excludes short-term flows.

^{b/} Projection by the World Bank.

^{c/} Due to the different coverage of countries, the figures are slightly different from those in table 1. For instance, Taiwan Province of China is not included here.

^{d/} Gross figures.

^{e/} Includes both publicly guaranteed and non-guaranteed loans.

^{f/} Excludes technical-cooperation grants.

13. Local capital markets are also expanding rapidly. The stock market in China alone grew from nothing in 1991 to \$32 billion in 1993. The market capitalization of the stock markets in the Republic of Korea, Malaysia and Thailand increased significantly: price indexes rose by more than, respectively, four times, two times and six times by the mid-1993 over 1984. ^{18/} It is evident from the experience of these countries that liberalized access of foreign firms to local capital markets has had a positive impact on the performance of their markets.

B. Foreign direct investment

14. Fuelled by high growth rates, large and increasingly affluent domestic markets, low production costs in a number of countries and a further liberalization of foreign-direct-investment policies, investment inflows in East, South and South-East Asia (including the Pacific) ^{19/} reached \$28 billion in 1992, an increase of 36 per cent over the previous year (table 1). With inflows exceeding \$11 billion, China emerged as the largest recipient of foreign direct investment among all developing countries in 1992, and dominated flows into Asia. ^{20/} Investments increased further to about \$26 billion in 1993. ^{21/} Excluding China, the increase in investment inflows to East, South and South-East Asia was considerably less in 1992: 5 per cent, for a total of \$17 billion.

15. Investment inflows in the Republic of Korea and Taiwan Province of China fell by 51 per cent and 31 per cent, respectively, in 1992 (table 7). Investments into Hong Kong and Singapore declined in 1991, then increased by 31 per cent and 28 per cent, respectively, in 1992. The amount of 1992 investment flows into Singapore was only 7 per cent higher than in 1990, and for Hong Kong it was only 40 per cent of the level of the 1990 flows.

16. Despite the decline or slow-down in inflows, the newly industrialized economies as a group attracted almost the same very high level of foreign direct investment in 1992 as during the late 1980s (figure 1), and they continue to rank among the top 10 recipients of this investment among developing countries. This performance may well signal the beginning of a structural change in response to a loss of certain advantages and the acquisition of new ones. Advantages that made these economies attractive to foreign investors in the 1980s - a stable macroeconomic climate, high growth rates of per capita income, expanding consumer markets, export-oriented trade policies, a well-developed (though in some parts crumbling) infrastructure, a highly productive and educated workforce with entrepreneurial capabilities and an indigenous suppliers' network - remain unchanged. Furthermore, Hong Kong and Singapore have the most liberal investment regimes among developing countries, granting, among other things, unrestricted national treatment to foreign investors in all areas.

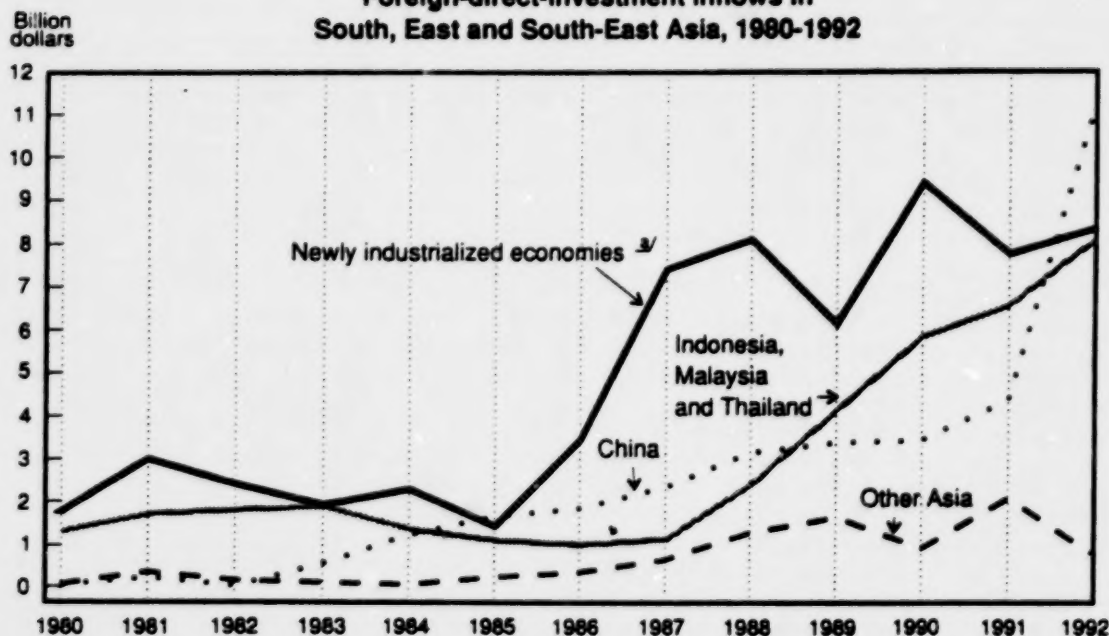
Table 7. Foreign-direct-investment inflows in selected South,
East and South-East Asian countries, 1981-1992

(Millions of dollars)

Country	1981-1985	1986-1990	1991	1992
	(Annual average)			
China	850	2 853	4 366	11 156
Hong Kong	576	2 034	977	1 272
India	59	167	141	151
Indonesia	236	599	1 462	1 774
Malaysia	1 083	1 123	4 073	4 118
Pakistan	77	175	257	275
Philippines	63	493	544	228
Republic of Korea	112	676	1 116	550
Singapore	1 349	3 247	4 395	5 636
Sri Lanka	42	40	68	123
Taiwan Province of China	189	987	1 271	879
Thailand	279	1 188	2 014	2 116
Viet Nam	6	6	32	24

Source: See table 1.

Figure 1.
Foreign-direct-investment inflows in
South, East and South-East Asia, 1980-1992



Source: UNCTAD Programme on Transnational Corporations, based on International Monetary Fund, balance-of-payments tape, retrieved on 13 December 1993, data from the OECD Secretariat and national official sources.

g/ Hong Kong, Republic of Korea, Singapore and Taiwan Province of China.

17. Despite these attractions, it appears that rising costs in excess of productivity gains and an overburdened infrastructure (predominantly urban and road transportation) have discouraged some types of foreign direct investment in these economies in recent years. Real wages increased by 30 per cent in Hong Kong, by 68 per cent in the Republic of Korea and by 36 per cent in Singapore between 1985 and 1990, ^{22/} while productivity gains during the same period were, for example, only 18 per cent in Singapore and 46 per cent in the Republic of Korea. ^{23/} The loss of cost advantages of these economies has induced not only foreign, but also domestic companies to shift labour-intensive production abroad and thus expedite the process of industrial upgrading at home. These economies (and, recently, Malaysia) are becoming increasingly interested not so much in the quantity, but rather in the quality of investments and wish to attract high value-adding activities of transnational corporations. ^{24/} The establishment by transnational corporations of research-and-development facilities or regional headquarters with important coordinating roles fosters an expansion or upgrading in their activities in the host countries that do not necessarily lead to large investment flows.

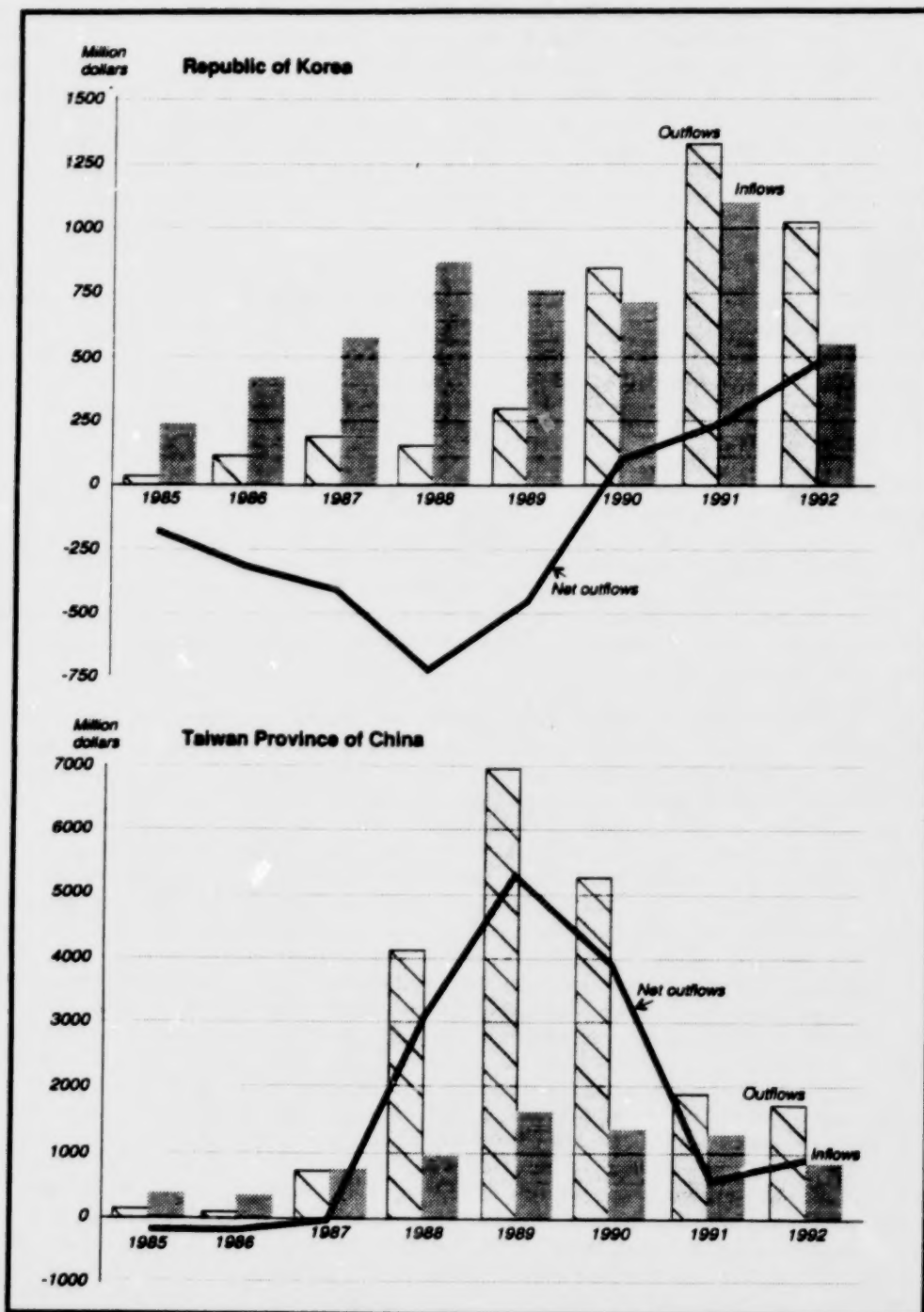
18. As regards outward investment, as part of the restructuring process, firms from the newly industrialized economies continue to invest abroad, in some cases to the extent that they became net foreign investors. For the Republic of Korea and Taiwan Province of China, outflows have exceeded inflows of foreign direct investment, since 1990 for the former and since 1988 for the latter (figure 2). Firms from Singapore, which have been lagging as outward investors compared with those from the other two economies, have recently undertaken a number of investments in China, Malaysia and Indonesia, in an effort to boost their regional presence. ^{25/} Although most of the foreign direct investment from the newly industrialized economies is located in developing countries of Asia, the share of North America and Western Europe in this investment has recently increased. ^{26/}

19. Investments in Asia are often motivated by rising production costs in home countries. Preferred investment locations have been the member countries of the Association of South East Asian Nations (ASEAN), but in 1993 China and Viet Nam became increasingly attractive. The level of investments in ASEAN countries except Singapore in 1993 reached only 60 per cent of the 1992 level. ^{27/} Foreign direct investment in developed countries typically seeks to secure market shares and access to technology. ^{28/} In addition to the newly industrialized economies, China, being the largest host developing country, has also become the largest source of foreign direct investment from developing countries, with investments in both developed and developing countries. ^{29/}

20. The fact that the share of the newly industrialized economies in investment inflows into Asia has diminished in recent years also reflects the emergence of a "second-tier" group of industrializing countries (Indonesia, Malaysia and Thailand) and China, where foreign direct investment grew rapidly in the late 1980s and 1990s, from low initial levels. Those countries became preferred locations for labour-intensive and, more recently, market-seeking foreign direct investment (including by transnational corporations from the newly industrialized economies) as a means both of reducing costs and serving the growing domestic markets. In Thailand, for example, there was only a 3 per cent increase in real wage rates between 1985 and 1991; the real wage level in that country was only 19 per cent of that of the Republic of Korea in 1991.

21. Japanese transnational corporations in particular have invested heavily in those emerging countries at the expense of the newly industrialized economies. Investment outflows into the newly industrialized economies from Japan, their principal source country, declined steadily from 60 per cent to 24 per cent of all investment outflows into South, East and South-East Asia between 1989 and 1992. ^{30/} Recently, Japanese transnational corporations facing financial difficulties and low profits at home and abroad, as well as an appreciating exchange rate, have been seeking to reduce costs by shifting production to the second-tier industrializing countries and China. In such cost-cutting efforts, wage increases that outstrip productivity gains appear to be an important consideration in the decision of Japanese firms as to where to locate production in Asia, which places the newly industrialized economies at a disadvantage.

Figure 2.
The Republic of Korea and Taiwan Province of China
as net foreign direct investors, 1985-1992



Source: UNCTAD Programme on Transnational Corporations, foreign-direct-investment database.

/...

22. An additional incentive to foreign direct investment in the region may come from the decision of the members of ASEAN to deepen economic integration by establishing, in 1993, the ASEAN Free Trade Area with a view to eliminating intra-regional tariffs and non-tariff barriers. Despite the fact that the members of ASEAN have already received considerable amounts of investments from outside the region, if the scheme succeeds in creating a larger economic area, it is quite likely that it will bring about a significant impact on flows of foreign direct investment from both outside and inside the region. The low level of trade interdependence among the ASEAN members - intra-regional trade accounted for only 17 per cent in the members' total trade in 1992 ^{31/} - indicates great potential for the expansion of mutual trade resulting from the elimination of trade barriers.

23. In summary, the decline or slow-down of investment flows into the newly industrialized economies reflects the loss of some advantages, especially in low cost production. These factors are, at least partly, compensated by large and growing domestic economies that offer investment opportunities to market-seeking foreign investors, new investment opportunities in services through the gradual removal of remaining barriers, and policies that encourage quality foreign direct investment that do not always become apparent in inflows. The last of these factors can contribute not only to the upgrading of domestic production structures, but also to the development of new advantages to attract activities of transnational corporations with a high technological content. The loss of foreign direct investment which was a result of traditional advantages need not cause concern if it reflects an economy's movement to a higher developmental stage. For the newly industrialized economies, that loss may have helped to accelerate the process of industrial restructuring by encouraging outward investment by domestic firms.

24. Investment inflows in South Asia increased by 18 per cent in 1992. Since the 1992 statistics do not capture the consequence of the ongoing liberalization of India's investment regime and its success in attracting foreign direct investment, inflows in this region are very likely to increase in 1993. Between August 1991 (when the new industrial policy liberalizing India's investment regime was introduced) and February 1993, more than 2,300 foreign collaborations had been approved in India, with foreign direct investment amounting to Rs 67 billion (\$2.6 billion), more than five times the total foreign direct investment approved between 1981 and 1990. ^{32/} Inflows into other countries in South Asia remain relatively small, hindered in part by the small size of the domestic market, though rapid growth was registered in Pakistan and Sri Lanka (table 7). Viet Nam, which opened to foreign direct investment only in 1988, has also experienced rapid increases in foreign direct investment, especially from other countries within the region. On an approval basis it attracted a total of nearly \$7 billion of investment by November 1993. ^{33/} The recent removal of restrictions to trade and investment by the United States should induce a further spurt of investment in Viet Nam.

25. The Middle East continues to receive small amounts of foreign direct investment (table 1). The attractiveness of that region largely depends on oil deposits. Low and relatively stable prices for petroleum since the latter half of the 1980s have not much encouraged investment inflows. The share of foreign-

direct-investment flows to this region in total flows to developing countries declined to less than 1 per cent in 1992.

III. LATIN AMERICA AND THE CARIBBEAN

26. The Latin American and Caribbean region continues to attract an increasing volume of foreign investment, after a very difficult period during the 1980s when foreign capital inflows virtually dried up and what little arrived was generally obtained only at the cost of substantial incentives. ^{34/} In particular, during the mid-1980s the region had lost its position as the principal recipient of foreign direct investment among developing countries as it was surpassed by developing Asia. ^{35/}

27. The revival of capital inflows to the region reflects not only the recovery of economic growth after the recession of the 1980s but also the abandonment of the particular import-substitution model ^{36/} that had been central to the Latin American scheme of industrialization and that had attracted the major part of foreign-direct-investment flows during the previous decades. The structural adjustment programmes carried out by most countries of the region, which encompass major initiatives in respect of market-oriented reforms - especially improvements in governments' fiscal positions - and a new external orientation, especially in terms of a liberalization of production, trade and finance, were showing results during the first years of the 1990s, not only with respect to economic activity in general but also with respect to foreign capital inflows in particular.

A. Net resource flows

28. Total net resource inflows to the region have increased substantially during the present decade, reaching an average annual level of \$32 billion during 1991-1992, up from \$13 billion during 1986-1990 (table 8). As a result, the region's share of these flows to developing countries rose from 17 to 21 per cent. For the first time since the international debt crisis engulfed the region, the net transfer of resources (subtracting interest payments and other net resource-service expenditures from resource inflows) turned positive in 1991. ^{37/} This encouraged further the reopening of capital markets for the region. Since the late 1980s, this has been accompanied by significant changes in the composition of resource flows. Before the debt crisis, during the late 1970s and early 1980s, flows to the region consisted mainly of bank credits lent to or guaranteed by Governments, or both. ^{38/} In the early 1990s, the dominant forms of external finance were non-bank foreign investment, either portfolio (especially equity shares) or direct, aimed at private companies (table 8).

Table 8. Latin America and the Caribbean: net resource flows, by type, 1986-1993 ^{a/}

(Billions of dollars)

Type of flow	1986-1990 (Annual average)	1991	1992	1993 ^{b/}
Foreign direct investment ^{c/}	6.4	12.4	14.5	17.5
Portfolio investment	-0.8	8.9	5.5	..
Bonds	-1.2	2.7	-2.4	..
Equity ^{d/}	0.4	6.2	7.9	6.0
International issues	..	4.7	4.0	..
Direct equity	..	0.8	3.6	..
Country funds	..	0.7	0.3	..
Loans	5.4	3.5	7.7	..
Official	5.2	2.4	0.3	3.4
Commercial banks ^{e/}	-0.6	2.8	9.7	..
Other private	0.8	-1.7	2.3	..
Grants ^{f/}	2.2	4.0	3.1	2.9
Total	13.2	28.8	30.8	37.5

Sources: The World Bank, World Debt Tables 1993-94: External Finance for Developing Countries, Volume 1. Analysis and Summary Tables, op. cit., pp. 186-189, and ECLAC/UNCTAD Joint Unit on Transnational Corporations.

^{a/} Excludes short-term flows.

^{b/} Projection by the World Bank.

^{c/} Due to the different coverage of countries, the figures are slightly different from those in table 1. For instance, Bermuda is not included here.

^{d/} Gross figures.

^{e/} Includes both publicly guaranteed and non-guaranteed loans.

^{f/} Excludes technical-cooperation grants.

29. The major change in the external finances of the region is the emergence of equity portfolio investment as a principal component of these finances. It increased from an annual average of \$360 million during 1986-1990 to an average of \$7 billion during 1992-1993. As a result, the regions's share in total equity investment flows to the developing world increased from 18 per cent during 1986-1990 to 46 per cent in 1993, while that of South, East and South-East Asia declined from 68 per cent to 36 per cent. Equity portfolio investments encompass several instruments. The most important ones are

international share issues, followed by direct equity purchases and country funds (table 8). Some of them are new. American Depository Receipts (ADRs), for instance, were invented to place new share issues on the United States stock markets. 39/ Argentine, Brazilian, Chilean, Mexican and Venezuelan private companies have been principal users of this instrument. Compared to international and direct share issues, country funds are not that important, measured by value. As a confidence-building factor during the late 1980s, however, they were quite important. 40/

30. The reasons for these changes include earnings differentials between investments in the United States and those in the region, and regained confidence in the security of investments in the region. Reduced gains from portfolio investments due to low real interest rates and sluggish markets (such as the real estate market) in the United States on the one hand, high real interest rates, appreciating currencies and large gains in local stock markets on the other hand led to a relative increase in the attractiveness of Latin American markets. 41/ This was particularly relevant for the new modalities of equity investment. 42/ Other factors include the economic recovery of the region, the international orientation of its companies, as well as liberalization measures that have provided better access to foreign investors and reduced transaction costs.

31. In summary, Latin America and the Caribbean have re-established their access to international capital markets. However, this does not imply a return to the same patterns that preceded the debt crisis. The reopening of capital markets for borrowers from the region rests primarily on access to new and different capital markets. The two principal novelties revolve around greatly increased portfolio investments (especially equity investments) and the revival of foreign-direct-investment flows. For the most part, this new situation relies more on non-bank investors in private sector enterprises than on bank loans to public sector borrowers.

B. Foreign direct investment

32. Foreign-direct-investment inflows to the region expanded in the early 1990s, doubling the annual average of 1986-1990 (tables 1 and 8). The rise in these inflows continued in 1993. As shown earlier, the resurgence of foreign-direct-investment flows to Latin America and the Caribbean was embedded in a broader phenomenon, that is, a substantial increase of private capital flows to the region.

33. One of the most interesting aspects of the increase in foreign-direct-investment flows during the past few years is that it has coincided with a relative decline in the use of exceptional incentive programmes, such as debt-equity conversions and privatizations. 43/ In this sense, a new kind of "normalcy" is reappearing in the region with respect to foreign-direct-investment inflows, viewed from the perspective of the instruments utilized.

34. As table 9 suggests, the new profile of a post-debt-crisis reality is taking shape. Some major debtor countries that undertook harsh adjustment programmes which incorporated heavy incentives, such as debt-equity conversions and privatization programmes, are now enjoying the fruits of stable growth. Among these fruits is the return of conventional (i.e., not heavily subsidized) foreign-direct-investment inflows. Such is the case for both Chile and Mexico. 44/ The new tendency towards normalcy in foreign-direct-investment flows appears to be most pronounced for these two countries.

35. A second category includes some major debtor countries that are still in transition from the foreign-direct-investment subsidization stage of the adjustment process to a sustained recovery stage characterized by more conventional foreign-direct-investment flows. For countries such as Argentina and Venezuela, for example, subsidized foreign direct investment still plays an important role in explaining foreign capital inflows (49 per cent in the case of the former in 1992, and 78 per cent in 1991 with regard to the latter though it declined sharply in 1992), and those inflows have not yet taken on a sustained nature. Fears have been expressed that subsidized foreign direct investment may result only in a change of ownership of existing assets without contributing substantially to the capital formation upon which much future growth depends. 45/

36. A third category includes major debtor countries that have not yet resolved the principal issues related to this indebtedness, that must make further efforts towards macroeconomic stabilization and that have not yet benefited substantially from foreign-direct-investment flows related to privatizations. Countries such as Brazil and Peru are in this category. Recent flows to Brazil, while relatively large in absolute terms, have been small in comparison to the size of the economy and the history of foreign-direct-investment inflows to that country. Brazil, however, may now be on a growth path.

37. Another interesting aspect of the renewed foreign-direct-investment flows to Latin America and the Caribbean is their destination. In terms of countries, it is more than evident that the flows during 1991-1992 for the countries listed in table 9 were increasingly concentrated in Mexico (34 per cent) above and beyond all others. Much further back in respect of volume were countries such as Argentina (22 per cent), Venezuela (9 per cent) and Chile (4 per cent). Announced foreign-direct-investment plans for 1992-1994 were very much concentrated in Mexico and Chile in value terms. 46/

38. The countries that succeeded in attracting considerable foreign-direct-investment flows did so especially in the services and natural resources sectors, sectors in which privatization programmes were concentrated. 47/ About \$7 billion (or two thirds) of the foreign direct investment that entered Mexico during 1991-1992 went into services industries (communications, tourism, financial and professional services). 48/ Similarly, \$1.1 billion foreign-direct-investment inflows into Argentina and \$1.5 billion into Venezuela were in this sector, primarily in the power-generation, telecommunication and transportation industries.

Table 9. Latin America and the Caribbean: foreign-direct-investment inflows, by instrument, 1988-1993

(Millions of dollars)

Country/instrument	1988	1989	1990	1991	1992	1993 ^g	1988-1993 total
Argentina							
Total	1 147	1 028	1 836	2 439	4 179	3 300	10 629
Conventional foreign direct investment	807	869	-80	1 596	2 112	732	5 294
Debt-equity conversion	340	159	815	-	-	-	1 314
Privatization	-	-	1 101	853 ^h	2 067 ^h	2 568	4 021
Brazil							
Total	2 969	1 267	901	972	1 454	2 000	7 563
Conventional foreign direct investment	882	321	618	850	1 359	-	4 030
Debt-equity conversion	2 087	946	283	68	95	-	3 479
Privatization	-	-	-	54	-	-	54
Chile							
Total	1 027	1 505	691	563	737	850	4 523
Conventional foreign direct investment	2	69	249	563	737	850	1 620
Debt-equity conversion	886	1 321	442	-	-	-	2 649
Privatization	139	115	-	-	-	-	254
Colombia							
Total	203	576	500	457	790	830	2 526
Conventional foreign direct investment	203	576	500	405	790	-	2 474
Debt-equity conversion	-	-	-	-	-	-	-
Privatization	-	-	-	52	-	-	52
Mexico							
Total	2 594	3 037	2 632	4 762	5 366	6 900	18 301
Conventional foreign direct investment	1 671	2 648	2 432	3 956	5 275	-	15 982
Debt-equity conversion	868	389	85	19	-	-	1 361
Privatization	55	-	115	787	91	-	1 048
Peru							
Total	26	59	41	-7	127	200	246
Conventional foreign direct investment	26	59	41	-7	-13	-	106
Debt-equity conversion	-	-	-	-	-	-	-
Privatization	-	-	-	-	140	-	140
Venezuela							
Total	89	213	451	1 916	629	256	3 298
Conventional foreign direct investment	39	30	148	161	545 ^g	256	923
Debt-equity conversion	50	183	303	256	70 ^g	-	862
Privatization	-	-	-	1 499	14 ^g	-	1 513
Total above							
Total	8 055	7 685	7 052	11 102	13 282	14 356	47 176
Conventional foreign direct investment	3 630	4 572	3 908	7 514	10 805	-	30 429
Debt-equity conversion	4 231	2 998	1 928	343	165	-	9 665
Privatization	194	115	1 216	3 245	2 312	-	7 082
Latin America and the Caribbean ^g	9 047	6 287	8 585	14 903	14 513	17 506	53 335

Sources: A. Caldarín, "Inversión extranjera directa e integración: la experiencia reciente de América Latina y el Caribe", *Industrialización y desarrollo tecnológico* (Santiago, CEPAL, 1993) and ECLAC/UNCTAD Joint Unit on Transnational Corporations.

^g Estimates by ECLAC/UNCTAD Joint Unit on Transnational Corporations.

^h All debt-equity conversion activities in 1991-1992 were directly related to privatization.

^g The difference in total inflows between this table and table 8 are mainly due to the inclusion of Bermuda here. Data for Bermuda for 1992-1993 are not available.

39. A second focal point of new foreign-direct-investment flows was natural resources. Here, the petroleum sector has been the largest recipient. The privatization of the State petroleum company, YPF, and State gas companies in Argentina, and the auctioning of petroleum concessions produced the single largest inflow of foreign direct investment during 1991-1992, at about \$2 to 3 billion. In Colombia, the new and massive Cusiana fields produced the recent increase in foreign-direct-investment flows there, which is expected to reach \$1.6 billion. 49/ Copper and gold mining projects, often in joint ventures with the State copper company, CODELCO, accounted for the single largest portion of new foreign direct investment to Chile (about \$1 billion); there is also significant activity in cellulose projects.

40. In the manufacturing sector, which used to be the core of foreign-direct-investment activity in this region during the inward-looking import-substitution period, foreign direct investment was less dynamic, although two major exceptions ought to be noted. The first concerns the adaptation of foreign affiliates already present in the region to the new liberalized and more competitive environment of the local market. Although the overall dimension of the phenomenon is still not clear, foreign direct investment, aimed at restructuring foreign affiliates of transnational corporations that once specialized in supplying solely local markets, with the aim of making them more internationally competitive, is becoming increasingly apparent as transnational corporations alter their international strategies to take into account the impact of trade liberalization in Latin America and the Caribbean. The clearest and most important example of this approach remains that of the automobile industry in Mexico 50/ where new investments in the order of \$4 billion have been announced for the 1993-1995 period. Announcements of major investments by automobile manufacturers in Brazil and Argentina in the context of Protocol 21 of the agreement establishing Mercosur suggest that the restructuring of this industry there is beginning to take form. 51/

41. The second major exception to the generally sluggish picture for foreign direct investment in the manufacturing sector in the region during the past few years concerns the maquiladora industry. The surge in foreign direct investment taking advantage of United States legislation that offers tax incentives for the use of export-processing zones for materials originating in the United States has continued. This investment goes not only to border industries in Mexico but to a number of small economies as well (Costa Rica, Dominican Republic and Jamaica). The principal activities involved here include electric and electronic equipment and clothing. Thus, unlike past experiences with foreign direct investment in the manufacturing sector, the new foreign direct investment is mainly characterized by an increasing specialization and an export orientation, as the automobile and maquiladora industries suggest.

42. In sum, foreign-direct-investment flows to Latin America and the Caribbean have strongly increased, with some subsidizing instruments (especially debt-equity swaps) becoming less important to attract such flows. Except for Mexico and perhaps Chile, privatization programmes remain an important tool to attract investment. Flows remain concentrated in a few countries and exhibit certain sectoral characteristics stemming from the particular situations of the principal recipients. Yet they have in common an increased export orientation. Overall, and with the exception of Mexico and to a certain degree Argentina,

manufacturing has, comparatively speaking, attracted less foreign direct investment. Inflows in the primary and tertiary sectors benefited greatly from privatization programmes. Within the basic framework of liberal foreign-direct-investment and trade policies, there may therefore be more scope to attract more investment into the manufacturing sector. Although the specific experiences of Mexico, and to a much lesser extent those of Argentina's privatization programme, have left a significant imprint on the new profile of the region during the 1990s, foreign direct investment is playing an important role in the growing integration of the region into the international economy.

C. Foreign direct investment and integration into the international market

43. The new economic policy in Latin America and the Caribbean clearly rests on the idea that the region's future depends on an improvement of its international competitiveness and its further integration into the world economy, now considered to be beneficial for the countries of the region. The means of this integration include not only trade but also external finance and, in particular, foreign direct investment. Therefore, the liberalization of legislation relating to foreign capital flows has been a prominent aspect of the region's landscape for several years now. 52/ While this perspective is generally shared by virtually all Governments of the region, strategies to attain this objective vary appreciably, especially in respect to the geographical scope of such integration (global, interregional or intraregional), its sequence and speed.

44. The framework for global integration is given by the multilateral trade negotiations within the Uruguay Round. Free trade agreements within the region exemplify intraregional efforts. And agreements with extraregional partners so far focus primarily on Mexico's participation in the North American Free Trade Agreement (NAFTA).

45. With regard to the multilateral trade negotiations, virtually all countries of the region have arrived at the conclusion that an open and unencumbered international trade, investment and financial system is of fundamental importance to their objectives. The region has supported therefore strongly not only the Uruguay Round but also greater trade liberalization in all its forms, especially that leading to increased access to the markets of developed countries. There was a considerable concern in many countries of the region during 1993 when doubts arose in respect to the successful conclusion of the Uruguay Round and United States approval of NAFTA. The best evidence of this new liberal policy is that the region, during the past decade, has embarked on the liberalization of foreign-direct-investment and trade policies, often in a unilateral fashion, coupled with a strong export orientation. In particular, the trade-liberalization programmes of nine principal countries of the region between the mid and late 1980s led to a reduction of average tariffs by half, from 20 to 40 per cent to 10 to 20 per cent; similarly, maximum tariffs and the number of tariff ranges declined steeply. 53/

46. The strengthening of intraregional links (without restricting further integration into the international market) has been based so far mainly on a

grid of bilateral agreements. ^{54/} Some 33 agreements were concluded during 1985-1993; of these, 27 were approved and 6 have implementation dates falling in the period 1994-1998. The most active countries have been Colombia (9), Venezuela (9), Mexico (8), Chile (7) and Argentina (5). While Colombia and Venezuela have concentrated more on agreements with partners within their Andean Pact integration scheme, Mexico and Chile have agreements with a wide array of partners, including extraregional ones in the case of NAFTA, which Chile expects to join in 1994. As a result of multilateral tariff cuts and these agreements, intraregional exports grew from 10 to 17 per cent of total exports between 1988 and 1992. Furthermore, foreign direct investment grew appreciably, admittedly from a narrow base. Chilean investments in privatized power companies in Argentina were prominent elements of this new regional foreign direct investment.

47. The NAFTA agreement represents so far the only free trade agreement involving extraregional (United States and Canada) partners. ^{55/} It has also the strongest provisions for the liberalization of foreign direct investment. ^{56/} Its negotiation provided a strong boost to foreign-direct-investment flows to Mexico during 1986-1992. As a result, that country emerged as the most important recipient of such inflows in Latin America and the Caribbean. Many transnational corporations have now incorporated Mexico into their international production systems. In fact, Mexican companies began to invest in the United States, most notably in the cement and glass industries.

48. Most of the other Latin American countries, fearing that NAFTA could develop into a sort of closed regional grouping with one or at most a few Latin American countries clustered around a North American core, have manifested their interest in becoming party to that agreement. The prominent exceptions have been Brazil ^{57/} and Cuba. High in the priorities of those wishing to join is the desire to gain improved access to the North American market. However, because foreign direct investment has become the principal means to gain such access as specialized suppliers to that market in the context of new corporate strategies by transnational corporations, the importance of attracting foreign direct investment is critical to obtain the benefits from NAFTA membership.

49. A principal reason why Latin American countries are interested in NAFTA over other integration schemes is that it represents an investment-led integration process, as evidenced by considerable foreign-direct-investment flows that Mexico has obtained. ^{58/} By comparison, other Latin American integration schemes, which were policy-led, have not generated much in the way of new foreign direct investment. That was most evidently the case of the Andean Pact, dating from 1969, which incorporated a foreign investment code (decision 24) in its original common market format. ^{59/} It also seems to be the case for the Mercosur (Argentina, Brazil, Paraguay and Uruguay) integration scheme, set to begin as a customs union in 1995. With the exception of foreign direct investment by automotive firms interested in taking advantage of the trade aspects of Protocol 21, little in the way of increased and sustained foreign direct investment has resulted from the Mercosur scheme itself.

50. In summary, the desire to attract foreign direct investment is the key factor behind the interest of Latin American and Caribbean countries in integrating with the North American market. While international liberalization

measures as well as intraregional trade agreements are creating a more competitive environment, they have led so far only to small increases of investment inflows meant to serve international or intraregional markets. As regards the latter, however, trade liberalization has laid the foundation for a restructuring of previously domestic-market-oriented foreign direct investment in the direction of regionally-oriented corporate networks (e.g., the automobile industry in Brazil). Progress towards greater economic regional integration could, therefore, generate and attract greater amounts of foreign direct investment for the regional market and, in this manner, contribute to the economic growth in Latin America and the Caribbean.

IV. CONCLUSIONS

51. Foreign direct investment to developing countries in the aggregate has grown rapidly in recent years, but the flows remain unevenly distributed among developing regions and countries. A number of Asian countries with rapidly growing economies and a well-trained, relatively low-paid labour force have been the main recipients of growing investment flows. In some countries in Latin America, adjustment programmes with debt-equity swap provisions and major privatization elements have accounted for much of the growth of foreign direct investment. For the most part, however, countries, in particular least developed countries, with low growth rates, small markets, unstable economic or political conditions, unresolved debt overhangs, few economically viable public enterprises to privatize and lacking a skilled even if low-paid workforce have seen their foreign-direct-investment levels stagnate at already low levels. The main exceptions to this generalization include those countries where deposits of natural resources are being exploited.

52. Prospects of future foreign-direct-investment flows to the developing countries as a whole are bright, and they provide grounds for guarded optimism with respect to some least developed countries as well. South, East and South-East Asia, as well as Latin America, are expected to experience strong growth in the foreseeable future. There is a strong relationship between the size of and/or changes in gross national product and inflows of foreign direct investment: in the case of South, East and South-East Asia, a one-per-cent increase in gross national product is expected to lead to a 1.6 per cent increase of foreign-direct-investment inflows; in the case of Latin America, that percentage is estimated to be 3.1 per cent. ^{60/} Furthermore, in Latin America the reduction of indebtedness plays a role in inducing inflows of foreign direct investment: a one-per-cent decrease in indebtedness is estimated to increase investment flows by 0.6 per cent. As the economies in these regions continue to grow and the size of debt is expected to decline, positive effects on flows of foreign direct investment into these regions should materialize.

53. Because of the tendency for key Asian host countries to graduate from foreign direct investment that is attracted by cheap labour to higher value-added forms of investment, it is not unreasonable to assume that some investment flows will be shifted from them; in fact, some of the newly industrialized economies and other developing countries in Asia are increasingly shifting some production to their lower-wage neighbours having a reasonably educated and hard-working labour force. Because of this, though competition may be keen, least

developed countries such as Bangladesh may stand to gain from some of the future flows of such investment.

54. To position themselves for future foreign-direct-investment flows, least developed countries may find it advantageous to emphasize policies that are investment-friendly, to foster human resources development and to create a stable economic environment. In particular, developing countries that continue to attract investment have invested substantially in both physical and human capital development. Gross fixed capital formation accounted for more than 29 per cent of gross domestic product in South, East and South-East Asia (table 2). In the least developed countries, only 15 to 16 per cent of gross domestic product was invested. As to human resources development, the percentage of the population in the age group enrolled in higher or tertiary education was only 4 per cent in 1990 in low-income developing countries, ^{61/} compared to 16 per cent in other developing countries. This share did not change during the past two decades for low-income developing countries, while some other developing countries experienced a significant growth in enrolment. In the Republic of Korea, for example, that share increased from 16 per cent in 1970 to 39 per cent in 1990; similarly, in Chile that share went up from 13 per cent to 19 per cent during the same period. ^{62/} Continued investments in fixed and human capital lay the ground for improving infrastructure that would help to provide macroeconomic stability and efficiency.

55. In view of the limited private resources flowing to least developed countries, official development assistance will remain essential for providing a good part of the necessary financing for these investments. In a number of cases, structural reforms may be important for obtaining and maximizing such external financial resources. At the same time, the public support from developed-country Governments and international organizations will be essential to the success of structural adjustment by least developed countries. ^{63/} Without such support, it is not likely that those countries could create conditions attractive to foreign investors and generate development on a scale sufficient to attract meaningful amounts of foreign direct investment.

Notes

1/ There are 47 developing countries recognized by the United Nations as least developed countries. For a listing, see UNCTAD, The Least Developed Countries 1992 Report (United Nations publication, Sales No. E.93.II.D.3).

2/ Ibid. See also table 5 for data on per capita gross domestic product.

3/ For a detailed discussion of issues related to the liberalization of foreign-direct-investment regimes, see document E/C.10/1994/7.

4/ Data for least developed countries in Africa exclude Liberia, because this country attracts occasionally large inflows of foreign direct investment to its flags-of-convenience facility, thus distorting flows to least developed countries. Flows to least developed countries in Africa were, during these years, as follows (millions of dollars):

Foreign-direct-investment flows to Africa	1988	1989	1990
Includes Liberia	459	949	631
Excludes Liberia	168	293	355

Source: UNCTAD Programme on Transnational Corporations, based on International Monetary Fund, balance-of-payments tape, retrieved on 13 December 1993.

5/ UNCTAD Programme on Transnational Corporations, based on International Monetary Fund, balance-of-payments tape, retrieved on 13 December 1993.

6/ See UNCTAD Programme on Transnational Corporations, "Foreign direct investment in Africa: report to the Commission on Transnational Corporations" (E/C.10/1994/5).

7/ UNCTAD Programme on Transnational Corporations, World Investment Report 1993: Transnational Corporations and Integrated International Production (United Nations publication, Sales No. E.93.II.A.14), pp. 66-67.

8/ See Paul Handley, "The old and the bold: far reaching economic reforms draw mixed reviews", Far Eastern Economic Review, 4 November 1993, pp. 30-31.

9/ See UNCTAD, The Least Developed Countries 1991 Report (United Nations publication, Sales No. E.92.II.D.1), p. 13.

10/ Ibid.

11/ Ibid.

12/ For recent developments in the external financing of developing countries, see UNCTAD, Trade and Development Report, 1993 (United Nations publication, Sales No. E.93.II.D.10), pp. 49-69.

13/ The region's share of resource flows here and in other parts of this report are calculated by measuring the importance of the data on the respective region (tables 6 and 8) in the context of the table on all developing countries of the World Bank, World Debt Tables 1993-94: External Finance for Developing Countries, Volume 1. Analysis and Summary Tables (Washington, D.C., The World Bank, 1993), pp. 170-173.

14/ Ibid., p. 5.

15/ To a certain extent, the distinction between "portfolio" and "direct" investment is a definitional one and certain thresholds are established because

they are assumed to connote control. On this and the links between these two forms of investment, see "Trends in foreign direct investment", E/C.10/1994/2.

16/ "Asia's wealth", Business Week, 29 November 1993.

17/ Nihon Keizai Shimbun, 19 January 1994.

18/ The World Bank, World Debt Tables 1993-94, op. cit., table 1.8, p. 26.

19/ Despite the rapid growth of investment inflows in the Pacific islands (from an annual average of \$139 million during 1981-1985 to more than \$500 million in 1992), they accounted only for 2 per cent of total flows into the region in 1992.

20/ It is believed that data on investment inflows and outflows for China reported by the International Monetary Fund (like other foreign-direct-investment data) disguise some domestic investment that is re-routed through foreign affiliates in Hong Kong back into China as foreign direct investment in order to take advantage of fiscal entitlements awarded to foreign investors. See Peter Harrold and Rajiv Lall, "China: reform and development in 1992-93", World Bank Discussion Paper No. 215 (Washington, D.C., The World Bank, August 1993).

21/ Tony Walker, "Investment in China set to top \$100bn", Financial Times, 8 November 1993, p. 5, and James Zhan, "The role of foreign direct investment in economic development and market-oriented reforms: the case of China", Transnational Corporations, vol. 2 (1993). Contracted foreign direct investment is expected to exceed \$100 billion in 1993.

22/ Real wage increases are calculated as nominal wage increases divided by consumer prices index. Data are from International Labour Office, Yearbook of Labour Statistics, 1993 (Geneva, ILO, 1993).

23/ The World Bank, World Development Report, 1990 and 1993 (Washington D.C., 1990 and 1993), table 7, pp. 190-191 and pp. 250-251, respectively.

24/ For example, the Statute for Industrial Upgrading that came into effect in 1991 in Taiwan Province of China provides incentives to transnational corporations engaging in research and development, the enhancement of productivity, training, the establishment of international brand names and the use of environmental protection systems. See, China External Trade Development Council, Doing Business with Taiwan R.O.C. (Taipei, China External Trade Development Council, June 1991).

25/ "Lee can do", The Economist, 21 August 1993.

26/ For example, PGI (Singapore) announced its intention to set up a manufacturing plant (electric and electronic equipment) and its European research-and-development headquarters in Scotland. See, James Buxton, "First Singapore company comes to UK", Financial Times, 16 November 1993.

27/ Outflows of foreign direct investment from the newly industrialized countries to ASEAN (except Singapore) were \$4.5 billion in 1992 and \$2.2 billion in January-September 1993. Nihon Keizai Shimbun, 3 December 1993, p. 9.

28/ United Nations Transnational Corporations and Management Division, Transnational Corporations from Developing Countries: Impact on Their Home Countries (United Nations publication, Sales No. E.93.II.A.8).

29/ Although a \$4 billion outflow was reported in 1992, it was probably inflated by the inclusion of funds that are "roundtripped" through Chinese affiliates abroad or other entities in order to be reinvested in China. See note 20.

30/ The Bank of Japan, Balance of Payments Monthly, No. 285 and 321 (Tokyo, April 1990 and April 1993). Even if foreign direct investment on an approval basis reported by the Ministry of Finance is used, the same conclusion applies. In this case, the share decreased from 59 per cent in fiscal 1989 to 30 per cent in fiscal 1992.

31/ Nihon Keizai Shimbun, 20 December 1993. The share of intraregional trade (exports) in total trade (exports) was 68 per cent for the European Union and 43 per cent for the North American Free Trade Area in 1992.

32/ UNCTAD, Ad Hoc Working Group on Investment and Financial Flows, "Case study submitted by India", TD/B/WG.1/Misc.3/Add.3, 27 May 1993, p. 28.

33/ Nihon Keizai Shimbun, 1 February 1994.

34/ A. Calderon, "Tendencias recientes de la inversión extranjera en América Latina y el Caribe: elementos de política y resultados". Paper presented at the IRELA seminar on "Foreign Direct Investment in the Third World", Segovia, Spain, 10-11 June 1993. See also the section on Latin America and the Caribbean in UNCTAD Programme on Transnational Corporations, World Investment Report 1993: Transnational Corporations and Integrated International Production, pp. 50-54.

35/ Ibid., p. 45.

36/ See J. Ramos, "Crecimiento, crisis y viraje estratégico", CEPAL Review, No. 50 (August 1993), pp. 65-73.

37/ Economic Commission for Latin America and the Caribbean, Estudio Económico de América Latina y el Caribe 1992 (Santiago, ECLAC, 1992).

38/ Michael Mortimore, "The conduct of Latin America's creditor banks", CEPAL Review, No. 37 (April 1989), pp. 7-26; and UNCTC, Transnational Banks and the International Debt Crisis (United Nations publication, Sales No. E.90.II.A.19).

39/ Access to American Depository Receipts by Latin American countries began with a Chilean telephone company in July 1990 and was given a big boost by the \$1.9 billion offering of shares by a Mexican telephone company in May 1991. This instrument consists of the issue of negotiable certificates by United

States banks ("depository banks") in representation of foreign shares. This mechanism facilitates intermediated share issues in the United States which are freely tradable, quoted in dollars and with dividends paid in dollars. The authorization of the Securities and Exchange Commission is required. Another related mechanism - Global Depository Receipts - allows for certificates to be floated simultaneously in different world stock markets.

40/ This mechanism allows foreigners to purchase shares on the local stock market in an indirect fashion via a controlled fund measured in dollars and quoted in global stock markets.

41/ "A survey of Third World finance: new ways to grow", The Economist, 25 September 1993.

42/ G. Calvo, L. Leiderman and C. Reinhart, "Capital inflows and real exchange rate appreciation in Latin America: the role of the external sector", IMF Staff Papers, vol. 40 (March 1993), pp. 108-151.

43/ None the less, it should be noted that Latin America has accounted for about two thirds of the 1,100 privatizations that took place during 1988-1992, as measured by revenue and foreign exchange receipts. See Frank Sader, "Privatization and foreign investment in the developing world, 1988-92", The World Bank Working Papers (Washington, D.C., The World Bank, October 1993).

44/ "A survey of Latin America: under construction", The Economist, 13 November 1993, p. 22. A caveat needs to be added here, however. In the case of Mexico, overall output growth since the reform process started in 1985 has barely exceeded the rate of growth of population. And the Chilean economy is still vulnerable to external shocks, because of strong dependence on the prices of copper, fish meal, pulp and paper, and fruit and on rather volatile and unpredictable capital flows.

45/ B. Kosacoff and G. Bezchinsky, De la Sustitución de Importaciones a la Globalización (Buenos Aires, ECLAC, May 1993); and J. M. Fanelli and J. L. Machinea, "Capital movements in Argentina". Paper presented to the ECLAC/IDRC Seminar on "New Private Flows to Latin America", Santiago, Chile, 6-7 December 1993. If the proceeds from debt-equity swaps are being used to reduce debt, this can free up savings for investment purposes.

46/ See AméricaEconomía, special issues, December 1992 and December 1993.

47/ See UNCTAD Programme on Transnational Corporations, World Investment Directory 1993, volume IV, Latin America and the Caribbean (United Nations publication, forthcoming).

48/ SECOFI, "La inversión extranjera en México", Comercio Exterior, 43 (March 1993), p. 213. Also see Edgar Ortiz, "TLC e inversión extranjera en México", Comercio Exterior, 43 (October 1993), pp. 971-972.

49/ In 1992 alone, \$440 million (or 56 per cent) of the foreign direct investment that entered the country that year went into petroleum, according to National Planning Department figures; see "Colombia: opening the door to foreign investment", a special sponsored section in Institutional Investor, 18

(December 1993), p. 4. Also see "Fin de siesta", AméricaEconomía, 79 (December 1993), p. 40.

50/ Michael Mortimore, "Transforming sitting ducks into flying geese: the example of the Mexican automobile industry", forthcoming; Mauricio de María y Campos, "Reestructuración y desarrollo de la industria automotriz Mexicana en los años ochenta: evolución y perspectivas", Estudios e Informes de la CEPAL, 83 (August 1992); and UNCTC, Foreign Direct Investment and Industrial Restructuring in Mexico, UNCTC Current Studies, Series A, No. 18 (United Nations publication, Sales No. E.92.II.A.9).

51/ The following investments were announced by automobile producers in Brazil and Argentina as of the end of 1993: Ford \$1,600 million, General Motors \$1,500 million, Fiat \$755 million and Kia \$500 million; see AméricaEconomía, Special Number, 1993-1994, pp. 23-24.

52/ See UNCTAD Programme on Transnational Corporations, World Investment Directory 1993, volume IV, Latin America and the Caribbean.

53/ M. R. Agosin and R. Ffrench-Davis, "La liberalización comercial en América Latina", CEPAL Review, 50 (August 1993), p. 44; and Asad Alam and Sarath Rajapatirana, "La reforma comercial en América Latina y el Caribe", Finanzas y Desarrollo (September 1993), p. 45.

54/ ECLAC, El regionalismo abierto en América Latina y el Caribe (Santiago, ECLAC, 1994), p. 10.

55/ It should also be mentioned that a number of small economies in the region, mostly in the Caribbean, are linked to the European Union through the Lomé Convention. However, this arrangement is not a free trade agreement, although it provides access to the European Union market on a preferential basis and contains a number of provisions aimed at stimulating foreign direct investment. It might be further mentioned in passing that a noteworthy extraregional forum - the Asia and Pacific Economic Cooperation Organization - admitted Mexico as a member in 1993, and Chile is expected to be admitted in 1994. While this obviously does not carry as much importance as a free trade agreement with extraregional partners, it does underline the growing international orientation of countries such as Mexico and Chile.

56/ See UNCTAD Programme on Transnational Corporations, World Investment Report 1993, op. cit., pp. 50-54.

57/ It might be recalled that, in the context of the clustering of international trade and investment, Brazil was one of only two Latin American countries clearly located in a non-North American cluster; the other country was Peru. See UNCTC, World Investment Report 1991: The Triad in Foreign Direct Investment (United Nations publication, Sales No. E.91.II.A.12), p. 56.

58/ See UNCTAD Programme on Transnational Corporations, World Investment Report 1993, op cit., and World Investment Report 1992, op. cit., pp. 40-44.

59/ See UNCTC, Regional Economic Integration and Transnational Corporations in the 1990s: Europe 1992, North America and Developing Countries, UNCTC Current Studies, Series A, No. 15 (United Nations publication, Sales No. E.90.II.A.14).

60/ UNCTAD Programme on Transnational Corporations, Explaining and Forecasting Regional Flows of Foreign Direct Investment (United Nations publication, Sales No. E.94.II.A.5), pp. 25-28.

61/ According to the definition of the World Bank that uses \$635 gross national product per capita as cut-off criterion, there were 40 low-income developing countries in 1991.

62/ The World Bank, World Development Report 1993: Investing in Health (Washington, D.C., The World Bank, 1993), table 29, pp. 294-295.

63/ As regards the latter, examples are the Structural Adjustment Facility (SAF) and the Enhanced Structural Adjustment Facility (ESAF) established in 1986 and 1987, respectively, in the International Monetary Fund. Low-income developing countries can obtain concessional loans up to 50 per cent of the country's IMF quota under the SAF and 110 per cent under the ESAF. As of July 1993, there were 36 low-income developing countries eligible under the SAF and 29 countries eligible under ESAF. See Susan Schadler, Frank Rozwadowski, Siddharth Tiwari and David O. Robinson, Economic Adjustment in Low-Income countries: Experience under the Enhanced Structural Adjustment Facility, IMF Occasional Paper 106 (Washington, D.C., IMF, 1993). The Special Programme of Assistance (SPA) for sub-Saharan Africa in the World Bank was launched in 1990. Currently 27 countries are eligible for this programme.



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COUNTRY AND REGIONAL EXPERIENCES IN ATTRACTING FOREIGN
DIRECT INVESTMENT FOR DEVELOPMENT

Foreign direct investment to the least developed countries
and other developing countries outside Africa

Report by the UNCTAD secretariat

Corrigendum

Footnote 24

Replace the existing text with the following:

24/ For example, the Statute for Industrial Upgrading that came into effect in 1991 in Taiwan Province of China provides incentives to transnational corporations engaging in research and development, the enhancement of productivity, training, the establishment of international brand names and the use of environmental protection systems.

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COUNTRY AND REGIONAL EXPERIENCES IN ATTRACTING FOREIGN
DIRECT INVESTMENT FOR DEVELOPMENT

Exchange of information on foreign direct investment

Report by the UNCTAD secretariat

SUMMARY

This report reviews briefly ongoing efforts regarding intergovernmental exchanges of information and experiences in dealing with foreign direct investment. Since these exchanges indicate that host countries are concentrating a good part of their policy efforts on the liberalization of their foreign-direct-investment regimes to attract foreign investors, the main body of this report examines the liberalization process. Firstly, it analyses it from a conceptual perspective, defining it as consisting of the elimination of restrictions and discrimination, the establishment of positive standards and the introduction, where need arises, of certain controls to ensure the proper functioning of markets. Liberalization is distinguished from other types of measures also aimed at attracting foreign investors and the broader regulatory context, while noting the interrelations between various policy measures. Secondly, the main trends and recent changes in policy measures regarding foreign direct investment are summarized to indicate how far the liberalization process has gone and what restrictions remain and why they are maintained. A summary appraisal of the main policy changes shows that unilateral efforts towards liberalizing national foreign-direct-investment regimes has brought about a remarkable level of convergence, despite the very few multilateral commitments that exist in this area. But liberalization measures alone are not sufficient to provide a favourable investment climate.

* E/C.10/1994/1.

Such measures need to be complemented with an appropriate basic legal framework, functioning legal and administrative infrastructures and with promotional activities. Taken together, these elements create a climate conducive to foreign direct investment. Lastly, the report underlines the importance of providing transparency of foreign-direct-investment regulatory frameworks through the international exchange of views and experiences.

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INTRODUCTION

1. In its resolution 1993/49, paragraph 18, the Economic and Social Council called upon Member States to exchange information among themselves, their interested private sectors and all competent organs, organizations and bodies of the United Nations system on their activities, programmes and experiences related to the promotion of foreign direct investment (FDI), in particular in developing countries. In addition, the Council requested the Secretary-General to prepare, as part of the documentation for the twentieth session of the Commission, a report on exchange of information on FDI. The present report has been prepared by the Programme on Transnational Corporations in response to that request.

2. Section I of the report reviews briefly the exchange of experiences on FDI by the Commission on Transnational Corporations, by UNCTAD's Ad Hoc Working Group on Investment and Financial Flows, and by the Organisation for Economic Cooperation and Development (OECD) among its member countries. Also relevant are the exchanges of experiences undertaken by UNCTAD's Ad Hoc Working Groups on Comparative Experiences with Privatization ^{1/} and Interrelationship between Investment and Technology Transfer. ^{2/} One of the principal themes emerging from these exchanges of information and experiences is the trend towards the liberalization of FDI regimes. Drawing on these experiences, section II analyses the process of liberalization of FDI policies from conceptual and empirical perspectives. Paragraphs 11 to 35 of that section examines the characteristics of the liberalization process in general and provides a conceptual framework for analysis, while paragraphs 36 to 59 - taking into account the discussions of the Ad Hoc Working Group on Investment and Financial Flows - assess how far the liberalization process has gone, what restrictions remain and why they are maintained. Section III outlines the importance of the broader context for policies on FDI. The report concludes with a note on the benefits of exchanges of experience and the increased transparency of investment policies associated with it.

I. EXCHANGE OF EXPERIENCES ON FOREIGN DIRECT INVESTMENT

3. Since FDI has become a principal topic in international economic relations and an important element of national and international development strategies, it has increasingly received attention by policy makers. Policies on FDI affect the overall level, sectoral composition and direction of capital flows and the trade, technology, training and financial flows associated with them, as well as the degree and type of production integration effected between countries. As a result, national FDI policies in one country can affect economic performance in other countries, especially given the role of transnational corporations (TNCs) as integrating agents of various international economic flows. This applies not only to host country policies but also to home country policies. Policy making in the area of FDI thus carries international, as well as national, implications.

4. One of the main tasks of the Commission on Transnational Corporations as the focal point within the United Nations system for all matters relating to foreign direct investment and transnational corporations has been to exchange

views among its member States on their experiences in dealing with FDI and TNCs. Such a dialogue in the Commission has helped to disseminate knowledge about the various policies and approaches of individual countries towards these corporations, and underscored the multiple interrelations of these policies with those in other countries. These discussions have helped to increase the level of convergence among national policies and normative frameworks. Furthermore, the exchange of information on national experiences with FDI has provided useful insights to both Governments and TNCs for the design of their policies and strategies.

5. The growing emphasis placed on FDI as an international policy issue is also reflected in the activities of UNCTAD's Ad Hoc Working Group on Investment and Financial Flows. While the focus of its discussions relating to FDI was on host country policies and measures to promote FDI, a wider range of issues was covered. The discussion on foreign investors' motivations benefited from the presence of non-governmental experts representing TNCs and academia. Home country studies were presented by the Netherlands, the Republic of Korea and the United States of America. 3/ These studies indicated measures being undertaken to encourage FDI in developing countries and countries in transition, such as the use of bilateral investment protection agreements, subsidies for feasibility studies and re-insurance of investment against political risks. On multilateral measures to promote FDI, representatives of the United Nations Industrial Development Organization (UNIDO), the World Bank and UNCTAD's Programme on Transnational Corporations presented their activities dealing with the provision of technical assistance and advisory services. The exchange of experiences on host country policies and measures to promote FDI was largely based on case studies presented to the Working Group by nine countries: Brazil, China, India, Mexico, Morocco, Myanmar, Nigeria, Philippines and Republic of Korea. 4/ These case-studies were prepared in accordance with a format suggested by the Ad Hoc Working Group's chairman, with the assistance of the UNCTAD secretariat. During the informal meetings, other countries provided an overview of their FDI policies. The discussion of policies was not limited to FDI-related measures but dealt also with the macro-economic policy framework, which has an important bearing on FDI flows and which represents an essential element in the creation of an enabling investment climate. The principal finding was that a widespread trend towards liberalization and market-oriented reform characterized economic policies, including FDI policies, since the 1980s. There was a high degree of policy convergence in terms of objectives, but variations existed in the pace, timing and degree of liberalization. The extensive discussions and exchanges of views in the Group have contributed to a better understanding of the issues relating to FDI and the motivations and concerns of the various actors involved, which is useful in policy formulation at both the national and international levels. 5/ The final report of the Ad Hoc Working Group will be made available to the Commission on Transnational Corporations. The report will contain the main findings and policy conclusions, as well as an assessment of the implementation of the work programme; it will also identify areas for further intergovernmental discussions and technical cooperation.

6. OECD, too, has considerable experience in the review of relevant country policies, beginning with reviews in the context of the codes dealing with the liberalization of capital movements and invisible transactions; the purpose of these reviews is to monitor compliance with the liberalization commitments

undertaken under the codes. (The codes cover most forms of FDI.) OECD has also reviewed country policies in connection with the national treatment instrument, with a view towards dismantling measures that are contrary to national treatment commitments, or to make these measures more transparent. Since 1991, the format of these reviews has changed. OECD now undertakes comprehensive reviews of the role of FDI in a country's economy and the country's policies on FDI, including sectoral restrictions, their interrelations with other aspects, such as trade. The reviews have helped to enhance the process of liberalization within the OECD area and contributed to a greater convergence of policies. They have also shown that there are many differences among OECD countries' policies, reflecting the different economic and social characteristics of individual countries, but also reflecting differing views and positions as to what types of measures and approaches to FDI are appropriate. Countries see in the review process an opportunity to explain their positions on FDI.

7. As the discussions in these bodies indicate, host countries are now concentrating a good part of their efforts on the liberalization of their FDI regimes, with a view towards attracting foreign investors. Where obstacles and disincentives once were the hallmarks of FDI rules, these have now been replaced by a series of measures aimed at removing such obstacles and disincentives and at placing foreign affiliates on a similar footing vis-à-vis national companies. 6/ Recent developments at the multilateral, regional and bilateral levels - for example, the conclusion of the Uruguay Round of multilateral trade negotiations (which includes agreements on international trade in services and trade-related investment measures), the ratification of the North American Free Trade Agreement (NAFTA), the efforts of OECD to formulate a wider investment instrument and the increasing number of bilateral investment treaties (United Nations Centre on Transnational Corporations, 1992; and UNCTAD Programme on Transnational Corporations, 1993) - are likely to add impetus to the process of liberalization of national frameworks already under way.

8. All these developments demonstrate that the trend towards liberalization of FDI policies is pervasive. It is - in its strength and depth - also relatively recent and has not yet been fully examined. There is still considerable uncertainty and confusion as to its actual character and contents. The next section of this report seeks therefore to clarify the meaning and distinguish the various elements that constitute the notion of liberalization of policies on FDI, before proceeding to examine how far the process has resulted in changed investment frameworks world wide. The precise impact of liberalization measures on FDI flows and their relative importance as compared to that of other factors and conditions in influencing such flows is a separate issue that is not addressed here. Moreover, specific policy conclusions - whether liberalization policies are to be recommended and, if so, under what conditions - can only be reached after examining their effects in concrete contexts. However, it can be expected that, to the extent that FDI frameworks become similar, specific differences that remain - everything else being equal - may influence decisions as to the location or expansion of investment projects.

II. THE PROCESS OF LIBERALIZING FOREIGN-DIRECT-INVESTMENT POLICIES

9. Since the early 1980s, more and more countries have changed their policies on FDI. 7/ Largely adopting a favourable approach towards FDI, they have sought to encourage and facilitate it and have undertaken to eliminate or temper restrictive policies and adhere to certain positive standards. This trend, widely known as "liberalization", has become more widespread during the early 1990s, as more developing countries and countries with economies in transition have joined in the process. Unilateral efforts 8/ towards the liberalization of national investment frameworks have led to remarkable similarities of investment policies and frameworks among countries from all regions (European Round Table of Industrialists, 1993 a and b). (But it has not led to a multilateral codification of what has been achieved so far, in an effort to provide the transparency and stability that is so important for a favourable investment climate.) Yet, the actual process of liberalization has been far from homogenous, and considerable differences remain in the nature, breadth and depth of the measures taken, reflecting different political, economic and social priorities, as well as different degrees in the decrease of state controls and planning and confidence in the ability of Governments to steer business processes. At the same time, this process is embedded in a broader liberalization trend concerning world trade and the transfer of technology, as well as progress regarding the strengthening of intellectual property protection. As in the case of trade, the establishment of a liberal framework for FDI, if properly undertaken, can be a process beneficial to the world economy as a whole, as well as to individual economies, to the extent that it encourages competitiveness and efficiency.

10. Thus, the process of liberalization of FDI policies needs to be seen as part of a broader process of liberalization of international markets and cross-border movements of factors of production that is taking place simultaneously - to a greater or lesser extent - in most parts of the world. It receives additional impetus from the emergence of an international integrated production system which increases the need for many TNCs to be able to integrate (horizontally and vertically) activities across borders. The complexity of creating a favourable climate for FDI operations by liberalizing FDI policies increase therefore.

A. Conceptual issues

1. Delimiting the notion of liberalization

11. A number of basic points must be made at the outset. The first one is implicit in the very term used, "liberalization process". The focus is on a process, not on a final or static situation. At the same time, one is not dealing with a mere continuum, a static line between two ideal ends, but with a dynamic process, a process that moves in a certain direction. A country's pertinent policies and measures at a particular point in time can therefore only be described in relative terms: they are more or less liberalized. As a result, the reference to a "liberalized regime" in what follows should be understood to mean, "reasonably liberalized", that is to say, a regime that has

gone a long enough way on the road to liberalization, so as to exhibit characteristics such as those to be enumerated.

12. The second point concerns the very meaning of liberalization in the area of FDI. According to common usage, this concept denotes the removal of restrictions on foreign investors and the decrease or elimination of measures tending to limit or condition the entry and operation of foreign enterprises. It is not impossible to operate throughout with such a negative approach to the notion of liberalization, describing all elements of the liberalization process in the area of FDI in terms of the removal of barriers, restrictions or discriminatory treatment. Despite its consistency, however, this approach is of limited usefulness because it treats in negative terms facets of the liberalization process that are normally understood as involving positive action regarding foreign investors. In particular, such key elements of the liberalization process as the grant of national treatment to TNCs and even the operation of a reasonably modern market-oriented legal system lose thereby something of their particular character and function. It is therefore useful for the purposes of this report to proceed on the basis of the view that an essential aspect of the liberalization process involves the adoption of, and adherence to, positive measures and standards.

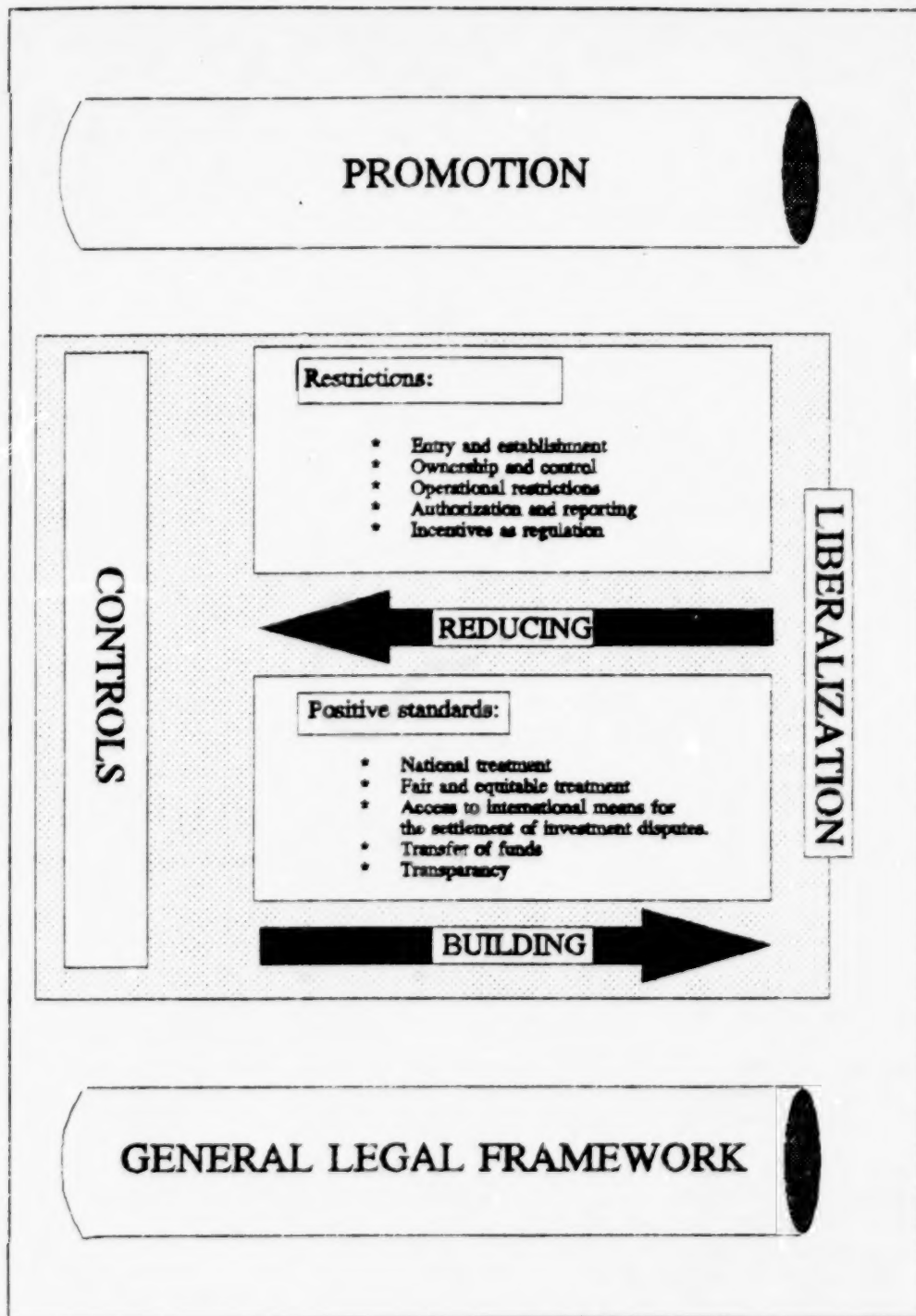
13. Furthermore, the overall positive effect of the liberalization process depends to a considerable extent on the presence and, where necessary, the strengthening of controls aimed at ensuring the proper functioning of the market and at protecting broader economic and social concerns. For instance, rules to assure competition and prevent abuse of market power are an integral part of a reasonably liberalized investment regime, as is the existence of an adequate regime for the protection of intellectual property. Similarly, prudential supervision of certain activities such as banking and financial services is necessary to ensure the reliability, stability and safety of the national financial system. The need to have appropriate health, safety, environmental and consumer standards is another illustration of necessary controls. Further, disclosure of information becomes more important for Governments, consumers and other groups since they have to be able to act in an informed manner. While meant to facilitate the function of the market, laws and regulations in these and other areas provide the framework within which enterprises conduct their affairs. To understand properly the liberalization process, therefore, one must determine not only its principal elements but also the kinds of legal and policy controls that are compatible with it, or indeed may be conditions for it.

14. The third initial point is that a clear distinction must be drawn between policies aimed at liberalizing FDI and policies aimed at creating a favourable investment climate and, especially, attracting or promoting FDI. The distinction is not an easy one in practice. The two types of policy complexes are closely linked in a means-to-end relationship: a principal aim of current liberalization measures is to attract FDI. Liberalization however is not the only possible method to attract FDI, nor is it necessarily the most effective one under all conditions. In the past (and, in many cases, still today), a variety of restrictive measures (typically, tariff protection) has been used in order to attract FDI. In fact, favouring FDI can be as interventionist a policy as regulating it - as, for instance, in the case of incentives and privileges offered selectively to TNCs.

15. A further difficulty in distinguishing the two policy complexes lies in the fact that, in addition to removing obstacles and restrictions to FDI, and to private investment in general, liberalization also includes a number of measures that are specifically addressed to FDI and reflect its special characteristics and peculiarities (e.g., special provisions for the free transfer of funds outside a host country).

16. In sum, a working definition of the liberalization process includes the tempering or elimination of restrictions on FDI by Governments, their adherence to certain positive standards of (equal) treatment and protection and the introduction of certain controls and prudential supervision to ensure the proper functioning of the market (figure 1). The present discussion starts therefore with the negative, the restrictions to be eliminated or tempered, and then proceeds to the positive traits and features of a liberalizing FDI regime, to conclude with a summary appraisal.

Figure 1. Main elements of the investment climate



2. Removal of restrictions

17. Any classification of restrictions on FDI is to some extent arbitrary, since fully consistent criteria cannot be found. Particular measures and policies usually have more than one purpose or effect, so that significant overlaps between categories cannot be avoided. All that can be attempted here is to review a number of policies and measures that are of importance, with an emphasis on their rationale and function.

(a) Entry and establishment

18. A first category of restrictions whose elimination is the hallmark of a liberalized FDI regime is that of restrictions on entry and establishment of FDI. Such restrictions generally seek either to limit FDI or to channel it and to determine or affect its likely effects, with a view to ensuring that the economy and/or its most important sectors are not dominated by foreign affiliates. The underlying rationale is the desire to keep in the hands of nationals of the host country the principal benefits from FDI, as well as decision-making control concerning the country's economic activity and growth. Foreign affiliates are assumed to be less likely to act in response to considerations of host country national interest and to be less subject to national governmental or political influence or control. (Proponents of liberalization challenge, of course, both the validity of such assumptions and the desirability of ensuring a degree of national control.)

19. The explicit purposes of such restrictions vary. One major category is the protection of national security, public order and vital national interests. These considerations tend to be regarded as natural exceptions to the general principles of liberalization and, as such, it is unlikely that they will disappear in the foreseeable future. Since, in the absence of an international framework on FDI, the determination of what constitutes a matter of public order or a threat to national security and vital national interests is left to the discretion of the host country, such considerations may be interpreted narrowly or more broadly. As this is the most widely accepted and the most "respectable" ground for restrictions on FDI, host countries may sometimes invoke it in order to exclude investments not wanted on other grounds. Restrictions on entry may also be directed at specific countries, as part of policies adopted for political reasons. The economic and social objectives of the host country are another major category of purposes served by such restrictions. In developing countries, in particular, restrictions on FDI are often used to promote specific development objectives; although there may be conflicts between particular objectives and economic policies, restrictive or otherwise, they generally have to meet criteria of economic efficiency. 2/

20. The case of policies and measures intended to keep FDI out of a country altogether is hardly real any more today. Restrictions on entry are generally partial. Restrictive measures are intended either to exclude or limit FDI from specific economic sectors, industries or activities, or to determine specific characteristics or effects of investments. Such restrictions tend to be justified on the basis of the strategic importance of the sectors involved for the host economy or, sometimes, with reference to particular industries or geographical locations, on national security grounds.

(b) Ownership and control

21. A second category or form of restriction affecting FDI are ownership requirements, especially limitations on the percentage of equity that foreign investors are permitted to own in local enterprises (in all sectors or more often in specified industries or activities) or requirements of local participation in the management of an enterprise (e.g., creation of joint ventures). A variety of methods have been used to ensure local participation in the internal decision-making of foreign affiliates.

22. Other restrictions of a similar character may also be imposed. Fade-out (disinvestment) requirements and requirements concerning the reinvestment of profits fall essentially in the same general category of direct restrictions on FDI, although they are no longer in use.

(c) Operational restrictions

23. Restrictions may also be imposed on a foreign affiliate concerning its operations after it has been established. Their purpose is to increase the benefits to be derived by the local economy from the operation of a foreign affiliate and to determine in specific terms some of the precise effects of such operation.

24. Such requirements may involve limitations on the employment of foreign managerial, technical or (less frequently) other types of personnel, priority employment of local labour and, in some instances, restrictions on access to local raw materials and supplies. They may also involve the imposition of performance requirements aimed at the promotion of exports, import substitution or the encouragement of local production (e.g., through local content requirements). Such requirements may be imposed at the time of entry as a condition for allowing the investment, or they may, more often, be linked to the offer of positive inducements, such as tax incentives. They had recently become more common, as substitutes for more rigid entry requirements, although, to the extent they may adversely affect foreign trade, they are, after the Uruguay Round agreement on trade-related investment measures, subject to international disciplines.

(d) Authorization and reporting

25. A fourth category of measures, whose restrictive effect depends on several factors, is those concerning authorization, registration or reporting in connection with various aspects of an investment. Certain distinctions must be made in this connection:

(a) Restrictions on entry and ownership may be applied on the basis of a screening process, a procedure whereby an investor's projects are assessed by the competent government agency in order to grant or deny authorization to invest;

(b) Authorizations and permits may also be needed for a variety of other purposes of varying importance, such as transfer of technology, importation or exportation, or to operate in certain activities;

(c) Registration or reporting are in principle less restrictive measures than authorization. They may be intended to enhance transparency, for general purposes (e.g., statistics) or in order to cope with certain aspects or effects of an investment, for instance, when seeking to determine the amount of funds (revenues or capital) that foreign investors will be entitled to transfer outside the country, or, of course, in response to environmental or consumer-protection concerns.

26. The actual restrictive effect of reporting requirements depends in large part on the mode of operation and the efficiency of the host country's public administration. When coupled with express or implied requirements of authorization, they may have a definite restrictive effect, often depending on the degree of discretion allowed to the pertinent authorities. Yet, even where they involve solely the provision of information (solely for purposes of transparency), bureaucratic requirements and procedures may bring about delays and other restrictive effects.

(e) Incentives as regulation

27. A fifth category of regulatory and sometimes restrictive measures consists of tax or other incentives designed to attract and encourage FDI. Evidently, such measures are intended to favour and attract rather than limit FDI and they differ significantly from those mentioned earlier. (Where such incentives are not available to local firms, furthermore, they effectively discriminate against them.) Yet they frequently have in fact definite restrictive effects. They are generally offered only to enterprises meeting certain conditions. They therefore require application or screening procedures and may be used (as they often have been in the past) in return for performance requirements or as an indirect means for regulating or channelling FDI: foreign investors may nominally be allowed to invest freely in the country concerned, but investors that meet additional conditions, frequently quite similar to the conditions on entry and ownership mentioned above, are subject to various kinds of approvals, granted special treatment - tax concessions and deferrals, exemptions from customs duties, guaranteed free transfer of funds, guarantees against unfavourable treatment (e.g., expropriation). Where such incentive systems exist, foreign investors generally prefer to use them and avoid taking the simpler but less attractive route of free entry, without special promises. Regulation through the offer and administration of incentives may be an effective substitute for direct controls over FDI. Although it is possible to establish incentive schemes with minimal regulatory (and restrictive) effects, such practices have not in fact been much in use in the recent past. It should be recalled, on the other hand, that whether tax and other incentives are successful and effective in attracting FDI is a matter of much debate.

28. As already mentioned, in a liberalized FDI regime, the restrictions and discriminations listed are tempered or eliminated, but the process should not be measured in simple arithmetical terms. In other words, the real outcome cannot be found through mere catalogues or simple calculations: which and how many restrictions have been eliminated, how many still remain. The relative importance of the various measures enumerated differs widely depending on the broader legal and economic framework and the quality of public administration of the country concerned. Moreover, the situation may vary significantly between

economic sectors. Restrictions may persist in certain sectors while others may be fully liberalized.

3. The role of positive standards

29. Most of the restrictive policies and measures listed above may be addressed solely to foreign investors, whether defined in terms of the nationality of the investors and enterprises involved or in terms of the origin of the capital. Some measures, e.g., entry requirements, are almost necessarily so addressed. In other cases, however, both foreign and domestic investors may be affected; for instance, certain sectors may be closed to all private investment, reporting may be required of all investors, export requirements may be imposed on all. While equality of treatment as between domestic and foreign investors - that is to say, for most purposes, the standard of national treatment - is undoubtedly a very significant part of the liberalization process, it does not exhaust the process. The two notions are not synonymous.

(a) National treatment

30. The granting of equality in the treatment of nationals and aliens, especially foreign affiliates, i.e., the national treatment standard, is an indispensable element of the liberalization process. While there are variations in the formulation of the standard in specific instruments, ^{10/} the basic concept of national treatment is that, in principle, foreign affiliates and domestic firms in similar situations should receive the same treatment, regarding such things as establishment, ownership and control of enterprises, full access to courts and other authorities and equal protection under the law, as well as taxation, labour law, consumer protection or protection of the environment, not to mention free access to credit facilities, or even government aid to enterprises (box 1.). Such a listing covers most of what is usually meant by liberalization. Restrictive measures such as limiting the access of aliens and foreign affiliates to legal process, imposing burdensome requirements for the recognition of foreign companies, denying aliens the right to hold real property, and others have sometimes been left over from much earlier times, when the law treated aliens and foreign companies with a high degree of distrust. In other instances, probably a minority by now, they reflect the same effort to limit and control foreign investments that other measures described here also involve.

31. However, equality of treatment with host country nationals and companies may not, in a number of cases, address pertinent problems adequately, especially where the objective situation of foreign investors is significantly different from that of domestic actors, as is the case in the transfer of funds abroad. The measures needed in such cases have to move beyond mere equality of treatment, although they are generally understood as covered by the notion of liberalization. Traditional, formal definitions of national treatment take care of most such problems by limiting application of the standard to "like situations" and by formulating the standard in terms of treatment "not less favourable than" that of nationals.

Box 1. National treatment as defined in the General Agreement on Trade in Services of the Uruguay Round of Multilateral Trade Negotiations

One of the most recent formulations of the standard of national treatment in a multilateral instrument relating to FDI is that contained in Article XVII of the General Agreement on Trade in Services (December 1993) which was approved by consensus. Article XVII states,

"1. In the sectors inscribed in its schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.

2. A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service providers.

3. Formally identical and formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or services providers of any other Member." a/

a/ GATT Secretariat, Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, MTN/FA, 15 December 1993.

32. Such issues raise important conceptual and practical problems. This is particularly true of the free-transfer-of-funds requirement. Where they still exist, exchange restrictions are general in character, that is to say, they apply to local as well as foreign enterprises. No formal discrimination against foreign investors is then necessarily involved in their application. A liberalization of FDI policies, however, is usually understood to cover the elimination of exchange restrictions to the extent that they affect foreign investment, on the not unreasonable ground that, generally speaking, the conditions of local and foreign investors and enterprises are significantly different with respect to questions of foreign exchange and funds outside the host country. For one, the headquarters, or profit centres, of local firms are by definition in the host country. At the same time, provision for the free transfer of funds means in reality, at least in principle, a guarantee to that effect. The host government undertakes not merely to allow investors to find foreign exchange, but to ensure that they find it. Moreover, procedural and other requirements, including the need for general or ad hoc authorizations and permits, generally intervene in the administration of such measures, so that in practice it is sometimes hard to distinguish between measures favouring (or privileging) investors and restricting them.

33. Other cases in the same broad category may be more controversial. For instance, in recent years the argument is increasingly advanced that, on lines essentially similar to those just mentioned (i.e., the specific character and needs of FDI), foreign affiliates should have free access to international arbitration for the settlement of any disputes between them and the host state, over and above the access to the local judicial and administrative machinery which they may have through the operation of a generalized national treatment principle. The specificities of FDI to which this claim corresponds are usually not spelled out in any detail. They may be understood to refer, on the one hand, to the likelihood that local courts and tribunals may lack the specialized competence in modern business law issues that an arbitration tribunal may provide and, on the other, to the fact that, since the investors are not nationals of the host country, they do not normally participate in national political processes and are more likely to be discriminated against by national authorities and tribunals. At any rate, provisions on international arbitration on FDI matters, whether under the auspices of the International Centre for the Settlement of Investment Disputes (ICSID) or otherwise, have found their way in numerous bilateral and multilateral agreements, so that the practice is becoming established and is reaching the point when it will be beyond theoretical argumentation.

34. Similarly, a foreign investor's access to a host country's legal process and to legal protection, part and parcel of national treatment as well as of liberalization, is in many instances strengthened by corresponding undertakings at the international level. To the extent that the (mostly conventional) international legal norms and concepts that have been developed, such as fair and equitable treatment, are now adopted in national legislation as well, it would appear that specific standards of legal protection, stronger or more specific than those applicable to nationals, are emerging.

(b) Transparency of laws, regulations and administrative practices

35. The effective functioning of the liberalization process requires that reliable information about FDI policies and practices be available. Transparency relates to the need for disclosure and clarity of all government measures that affect the operation of foreign affiliates in a host country. In that sense, transparency involves the publication within a host country of relevant measures in whatever formal manner is provided by national law, and they are to be made available to interested persons within the bounds of the customs and practices prevalent in the country concerned. A gradual approach to the achievement of transparency would involve the elimination of deliberate administrative obfuscation and secretiveness. A system of formal publication of laws and regulations is also important. Notification or other special forms of publication may be feasible only with respect to limited, precisely defined issues and types of measures.

B. Country experiences with liberalization

36. A detailed survey of the current situation with respect to normative frameworks on FDI is not undertaken here. Yet, drawing partly on the results of the country studies submitted to the Ad Hoc Intergovernmental Working Group on

Investment and Financial Flows, 11/ and on surveys and a review of other pertinent data (European Round Table of Industrialists, 1993b; United Nations Centre on Transnational Corporations (UNCTC), 1992a, 1992b, 1993; UNCTAD, 1994a, 1994b; Office of the United States Trade Representative, 1992; World Bank, 1992; OECD, 1992 and 1993), it is possible to provide a reasonably faithful summary account of the extent to which the liberalization process has gone today, starting with the elimination or decrease of restrictions and moving to the establishment of positive standards (tables 1 and 2).

Table 1. Standards of treatment for foreign direct investment in bilateral investment treaties,* December 1991

Standard	Number of countries, by region, that provide the standard				
	Africa	Asia and Middle East	Latin America and Caribbean	Eastern Europe	Western Europe
1. Admission					
a) In accordance with legislation, regulations, administrative practices and economic policies	62	65	25	19	5
b) Endeavour to admit in accordance with the laws (regulations)	0	9	0	0	0
c) In accordance with national treatment / most-favoured-nation treatment standards	2	1	3	0	0
d) No admission clause	27	16	2	7	6
2. Treatment					
a) Fair and equitable treatment	93	81	30	26	8
b) National treatment (and fair and equitable treatment)	8	1	0	0	0
c) Most-favoured-nation treatment (and fair and equitable treatment)	59	60	2	30	2
d) National treatment (and most-favoured-nation treatment)	141	78	52	15	13
e) Treatment not to privileges granted on basis of customs union, taxation treaty, etc	53	51	22	19	10
3. Transfer of capital and return of funds					
a) Without delay	99	84	29	28	9
b) Installments	16	9	12	4	2
c) Interest for delay	6	5	4	6	1
d) Rate of exchange official / market	20	30	16	18	3
4. Settlement of disputes					
a) Arbitration clause	99	87	30	22	9
b) Reference to ICSID	45	53	21	15	3
c) No arbitration clause	1	0	0	0	0

Source: Based on a survey of 253 bilateral treaties conducted by the World Bank, Legal Framework for the Treatment of Foreign Investment, volume I, Survey of Existing Instruments (Washington D.C., The World Bank Group, 1992).

* Bilateral investment treaties conducted with the following OECD countries: Belgium and Luxembourg, Denmark, France, Germany, Netherlands, Norway, Sweden, Switzerland, United Kingdom and United States.

Table 2. Standards of treatment for foreign investors in selected national investment codes, December 1991

Standard	Number of countries, by region, that provide the standard			
	Africa	Asia	Latin America and the Caribbean	Central and Eastern Europe
1. Admission				
a) Authorization required	10	8	5	4
b) No special restrictions for entry	16	1	2	1
2. General standards of treatment				
a) National treatment	18	2	4	4
b) Fair and equitable treatment	1	2	0	0
c) No provision	7	5	3	1
3. Transfer of capital and profits				
a) Unconditional transfer	1	0	0	1
b) Transfer subject to regulations	20	3	4	3
c) Transfer subject to regulations and installments on liquidation or only after a specified period	5	4	2	1
d) No provision	1	1	1	0
4. Dispute settlement				
a) Local courts	2	3	0	0
b) Courts or domestic or international arbitration	22	3	2	2
c) No provision	2	3	5	4

Source: Based on a survey of 48 national investment codes conducted by the World Bank, Legal Framework for the Treatment of Foreign Investment, volume I, Survey of Existing Instruments (Washington D.C., The World Bank Group, 1992).

1. Entry and establishment

37. Today, all countries around the world admit FDI in principle, and total prohibition of FDI no longer exists. However, no single country (even among the strongest advocates of a liberal FDI regime) grants an unrestricted right of entry to all sectors and activities. It is difficult, none the less, to make generalizations about the types of industries that remain restricted, as these vary considerably from country to country.

38. In the developed countries, some activities in the natural resources sector that had traditionally been kept in the hands of the State, have been liberalized, although many restrictions remain, for example, in the fishing, mining, oil and energy industries. The manufacturing sector is now practically open in these countries, while many of the restrictions and regulations previously maintained in the services sector are being gradually lifted. Some restrictions remain in a few but important services industries, such as telecommunications, maritime, land and air transport, media activities and professional services (UNCTC, 1993; OECD, 1992).

39. In the developing world, the picture is more complex and diverse. The liberalization process of the 1980s has been selective, with a tendency to focus mainly on export-oriented manufacturing industries or projects involving advanced technology. Gradually, other manufacturing industries have been opened to FDI. Certain services industries traditionally closed or restricted to FDI have started to be liberalized, although, in general, the liberalization of services has not yet reached the levels typically found in developed countries, other than within regional integration schemes. More recently, certain restrictions in the natural resources sector have been lifted, even by privatizing what had been nationalized in previous decades (UNCTC, 1992a, 1992b; 1993; UNCTAD, 1994a, 1994b).

40. It is likely that the process of liberalization initiated in all sectors will continue in the future, supported by regional and multilateral initiatives aimed at achieving that goal. For example, the adoption of the European Energy Charter currently under negotiation could have major implications for the liberalization of the energy industry in Eastern Europe. Similarly, the recently concluded agreement on trade in services within the framework of the Uruguay Round of multilateral trade negotiations will provide impetus for the removal of additional restrictions in services industries, both in developed and developing countries (GATT secretariat, 1993).

2. Ownership and control

41. Compulsory majority and minority shareholdings have lost importance over the years as a means of restricting the entry of FDI. Most developing countries that used to impose such restrictions across the board now generally allow full ownership of foreign affiliates. However, ownership limitations continue to be used as a means of restricting FDI in specific industries and activities. Developed countries sometimes use restrictions in shareholding to limit access in privatization cases or in services industries (e.g., telecommunication, broadcasting, air transport) that have not yet been completely liberalized.

Moreover, some countries, both developed and developing, continue to impose limitations on the number of foreign firms allowed in certain industries such as banking, financial, professional, telecommunications, air transport and broadcasting.

42. Restrictions affecting the structure of control in foreign affiliates continue to be used in developing countries, and less frequently in developed countries, particularly in large investments in industries or activities of crucial strategic importance for the local economy. They are also in use in cases of privatization of public monopolies in which the State continues to play a role. A common instrument of internal control is the granting of golden shares to the host Government; this, among other things, permits it to appoint a certain number of members on the boards of directors and to intervene if a foreign investor captures more than a certain percentage of the investment. In addition, it is still not uncommon for developing countries to impose restrictions on the national composition of management, or to require local participation in the management of a foreign affiliate.

43. Another modality of FDI restrictions that was used in the past by developing countries (in particular by the Andean countries, as part of the common regime for FDI promulgated by the Andean Pact) consisted of "fade-out" requirements, whereby foreign investors were obliged to pass on the investment to national hands over a period of time (normally 10 to 15 years). With the change of the Andean Pact regulations on this point, "fade-out" requirements have virtually disappeared (UNCTAD, 1994b).

3. Operational restrictions

44. Restrictions on the employment of aliens are ubiquitous, most often on the basis of general legislation on immigration and employment rather than of laws relating to FDI. The latter deal in many instances with issues that specifically affect FDI, in particular the employment of professional and managerial personnel. Employment matters may become the subject of performance requirements, when developing countries require employment and training of local labour as a condition for allowing an investment or for granting special treatment (tax incentives) to it.

45. Performance requirements have shown in recent years a tendency to loosen their compulsory character and, instead, tend to be related to positive inducements. While statistical data from the late 1970s and early 1980s showed a widespread use of various types of performance requirements, indicating a growing emphasis on domestic value added and exports, some authors have noted more recently that developing countries have been relaxing some performance requirements during the 1980s (UNCTC and UNCTAD, 1991). ^{12/} Performance requirements can also be found in private agreements with specific investors.

46. There are, of course, other types of operational restrictions. One of them, important for many companies, concerns the ability of foreign affiliates to raise capital locally. Restrictions of this sort are now being lifted in a number of countries, at times in connection with the promotion of emerging capital markets.

4. Authorization and reporting

47. While in a considerable number of countries the laws may not impose explicit restrictions on FDI, Governments may continue to exercise significant controls over its entry by imposing screening procedures. Such procedures have been abolished in most developed countries and tend to disappear gradually in developing countries as well, being replaced by registration or notification. Yet, some kind of screening continues in many instances, where authorization or special permission is still required for entry into specific industries or types of activities, or for investments above certain amounts, or where the Government reserves its right to deny entry to FDI on grounds of national security (UNCTC, 1992a, 1992b, 1993; UNCTAD, 1994a, 1994b).

5. Investment incentives

48. Countries, both developed and developing, use a wide variety of incentives to promote their policy objectives. In the main, incentive programmes do not discriminate in favour of foreign investors. When they do, it is to attract them to certain industries, or they are linked to export promotion, structural adaptation, training or the introduction of advanced technology. Among the many types of incentives schemes, industrial estates, special economic zones, bonded areas, export-processing zones and, more recently, science parks have attracted considerable attention. In addition, a broad variety of financial incentives, particularly in the form of subsidized sites, other infrastructure facilitation and business services, are offered by regional and city authorities to encourage regional development. In recent years, countries have become more selective and focused in their granting of incentives that are often made conditional upon certain performance requirements being fulfilled by the investor. This responds to the general perception that incentives are only a second-best solution to attract investment, and that, as host countries compete with each other in the granting of incentives, these tend to cancel each other out and simply raise the rents to private investors without increasing the social benefits of the projects for the countries concerned.

49. As already noted, many countries that otherwise do not require authorization for entry have established various criteria and requirements as prerequisites for the grant of tax concession and other kinds of privileged fiscal regimes and other incentives. The administration of investment incentives involves by necessity screening on the part of the competent authorities. Such procedures can be painless in the ideal case of a perfectly functioning civil service but in actual cases they can constitute problems for the foreign investor. A number of countries are moving away from special incentives towards reformulating their overall fiscal regimes.

6. National treatment

50. Most developed countries grant in principle national treatment unilaterally to all potential foreign investors as part of their constitutions and basic laws (including civil and commercial codes) (OECD, 1991 and 1993). In addition, many of them have undertaken international commitments in that respect in the context

of regional integration schemes. Moreover, in the context of regional agreements and bilateral investment treaties with developing countries, many developed countries have adopted reciprocal obligations to grant national treatment (table 1). As a result, there is now a broad network of international commitments on national treatment covering a large proportion of developed and developing regions.

51. According to a recent survey of 48 investment codes adopted by developing countries conducted by the World Bank (World Bank, 1992; UNCTC, 1988 and 1992b) (table 2), the overwhelming majority of the developing countries surveyed have adopted provisions to the effect that there shall be no discrimination against FDI as compared with local investors. At the same time, many of the countries that adopt this principle have favoured a definition of national treatment as being treatment similar or equal to that given to local investors, thus excluding the possibility of granting more favourable treatment to FDI.

52. When a country commits itself to grant national treatment to FDI, it is normally assumed that the principle applies to all aspects of the operations of a foreign investment in the host country, unless specifically indicated by way of exceptions. The categories of exceptions may vary from country to country but tend to be largely similar to those imposed on entry and establishment (e.g., national security, the protection of vital political and social interests, the furtherance of development objectives) (box 2).

Box 2. Restrictive measures affecting the national treatment standard in OECD countries

Recent surveys on the application of the national treatment standard among the OECD countries have identified a number of areas where discrimination between foreign affiliates and national enterprises tends to be particularly significant. a/ These include,

* Investment by established foreign-controlled enterprises. Limitations on reinvestment are found in a number of developed countries, particularly in the natural resources and services areas. The most common are those affecting the scope of business operations and the volume and range of production. In the area of banking and financial services, limitations on the scope of business operations for established foreign affiliates are still being used.

* Official aids and subsidies. While the general approach in developed countries is not to discriminate between foreign and local investors regarding official aids and subsidies, at times these are granted on a discriminatory basis in order to promote local industries and activities, for example in the areas of subsidies by local authorities and those relating to research and development. The opposite is also true sometimes: foreign investors may be given advantages or facilities not available to national enterprises, typically as a means to encourage them to invest at the particular location.

* Taxation is another area in which the treatment of foreign affiliates and branches is often less favourable than that accorded to national enterprises in the same situations. In particular, developed countries tend to discriminate in the treatment of dividends paid abroad, the differences in tax rates applied to local enterprises, and the tax treatment of branches of foreign-controlled enterprises.

* Government procurement. Governments often give preferences to national firms in bidding on public procurement contracts. Pertinent examples of policies pursued by developed countries include outright prohibition of foreign sourcing, formal criteria for allowing foreign sourcing, and procedures favouring procurement from national firms. In addition to the distinction between national and foreign firms, rules of origin might qualify as foreign the products of foreign-controlled enterprises established in the host country, thus excluding them for public procurement purposes. Most developed countries still continue to reserve government procurement to nationally owned firms.

* Access to local credit by foreign-controlled firms. Foreign affiliates may be prevented from borrowing or raising capital in the host country and thus need to rely on foreign finance for their capital needs. Such restrictions may respond to a host country's need to avoid shortages of capital or foreign exchange, or to prudential considerations. These limitations are imposed by developed countries, although their use has diminished significantly during the past decade.

* Access of foreign-controlled firms to communication and distribution networks may be restricted by government measures or discriminatory practices, since many telecommunications, postal, computer networks or similar services are public monopolies. Such practices tend to be less frequent in developed countries today.

a/ OECD, National Treatment for Foreign Controlled Enterprises (Paris, OECD, 1993).

7. Transparency of laws, regulations and administrative practices

53. In recent years, Governments have made considerable efforts to publicize and disseminate information on their policy, normative and administrative frameworks relating to FDI and to ensure that this information reaches potential foreign investors. Such efforts are usually part of broader promotion activities to attract FDI. They seek to facilitate the understanding of the countries' FDI regime by presenting the key features of such regimes in a simple and concise manner. Governments that screen foreign investors through authorization procedures have also sought to improve the transparency and efficiency of such procedures by establishing "one-stop shops" dealing with all the approval requirements. Some of these agencies are charged with both screening and promoting FDI and, thus, furnish foreign investors with relevant

information to assist them in their establishment and operations. Frequently, however, the impact of these one-stop shops is negligible.

54. Transparency can be expected to be increased as part of the implementation of the General Agreement on Trade in Services and the agreement on Trade-related Investment Incentives, negotiated as part of the Uruguay Round. These commitments underscore the fact that transparency of regulations is an essential part of the liberalization of FDI policies. Other international organizations, such as the International Monetary Fund, the World Bank, the OECD and various regional integration schemes, routinely collect information regarding various FDI policies and measures. However, a mechanism for international transparency in all areas of FDI and for all countries does not exist, reflecting the fact that FDI is not governed by an international framework of rules that would necessitate international notification and reporting as a means of ensuring that the signatories adhere to their commitments.

8. Transfer of funds

55. While exchange controls are far less prevalent now than they were 40 years ago, they are still present today all over the world, although their precise form and the extent vary widely (tables 1, 2 and 3).

56. At present, all developed countries allow, in principle, the free repatriation of the foreign capital invested. Most restrictions on transfers of profits and dividends have also been abolished in most developed countries (OECD, 1992 and 1993). With respect to the developing countries, two opposite trends concerning exchange regulations took place during the 1980s. On the one hand, developing countries faced with debt-servicing problems increased their controls in order to stem foreign exchange outflows. On the other hand, most surveys (UNCTC and UNCTAD, 1991) noted a general relaxation of foreign exchange controls, as developing countries engaged in intense competition for FDI. According, however, to a recent survey of 48 developing countries conducted by the World Bank (World Bank, 1992) (table 2), only two of these countries grant foreign investors an unrestricted transfer of payments and capital. A small number of countries requires that capital be repatriated only after a specified period of time, or in instalments. The majority of the remaining countries, including countries from all developing regions, guarantee transfers of both capital and profits in principle, while making such guarantee subject to foreign exchange regulations. Thus, an increasing number of countries have accepted in principle the commitments of Article VIII of the International Monetary Fund's Articles of Agreement to avoid restrictions on current payments, including remittances of profits (figure 2), while, at the same time, a number of these countries have continued to impose temporary restrictions on such transactions invoking the balance of payment exception authorized under the Agreement (figure 3). 13/

Table 3. Changes in the regulation of repatriation of income and capital, selected developing countries, 1988-1993

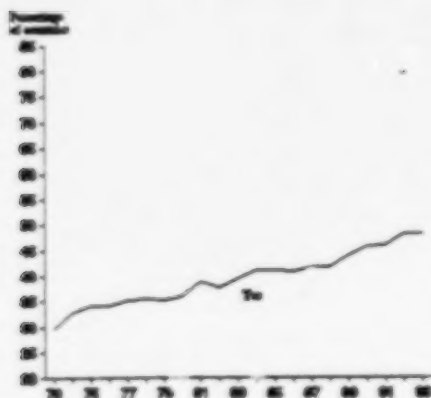
Country	Repatriation of capital and income									
	1988		1989		1991		1992		1993	
	I	C	I	C	I	C	I	C	I	C
Argentina	SR	SR	F	F	F	F	F	F	F	F
Bangladesh	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR
Brazil	F	SR	F	SR	F	F	F	F	F	F
Chile	F	SR	F	SR	F	SR	F	SR	F	SR
Colombia	SR	F	SR	F	SR	F	F	F	F	F
Costa Rica	SR	SR	SR	SR	SR	SR	SR	SR	F	F
Greece	SR	SR	SR	SR	SR	SR	SR	SR	F	SR
India	SR	SR	SR	SR	SR	SR	SR	SR	F	F
Indonesia	SR	SR	F	F	SR	SR	SR	SR	SR	SR
Jamaica	SR	SR	SR	SR	SR	SR	SR	SR	F	F
Jordan	F	F	F	F	F	F	F	F	F	F
Korea, Republic of	F	F	F	F	F	F	F	F	F	F
Malaysia	F	F	F	F	F	F	F	F	F	F
Mexico	F	F	F	F	F	F	F	F	F	F
Nigeria	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR
Pakistan	SR	SR	SR	SR	F	F	F	F	F	F
Peru	R	R	R	R	R	R	F	F	F	F
Philippines	F	F	F	F	F	F	F	F	F	F
Portugal	F	F	F	F	F	F	F	F	F	F
Sri Lanka	SR	SR	SR	SR	SR	SR	SR	SR	SR	SR
Thailand	SR	SR	F	F	F	F	F	F	F	F
Trinidad and Tobago	SR	SR	SR	SR	SR	SR	SR	SR	F	F
Venezuela	SR	SR	SR	SR	SR	SR	SR	SR	F	F
Zimbabwe	R	R	R	R	R	R	R	R	R	R

Source: International Finance Corporation, Emerging Stock Markets Factbook (Washington D.C., IFC, 1988 through 1993).

Key:

- I - Repatriation of income (dividends, interest and realized capital gains).
- C - Repatriation of capital (initial capital invested).
- F - Free (repatriation is done routinely).
- SR - Some restrictions (typically requires some registration with or permission of Central Bank, Ministry of Finance, or an Office of Exchange Controls that may restrict the timing of exchange release).
- R - Restricted.

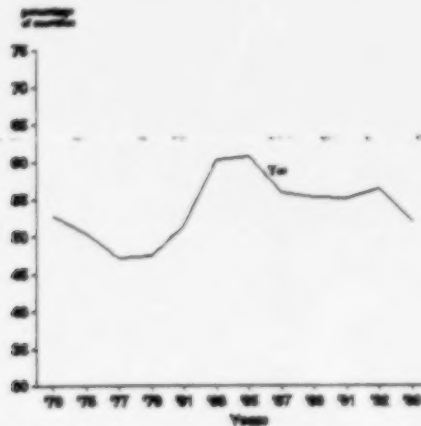
Figure 2. Countries that have undertaken commitments to avoid restrictions on remittances of earnings, a/ 1973-1993



Source: International Monetary Fund, Exchange Arrangements and Exchange Restrictions, Annual Report (Washington, D.C., IMF, 1973 through 1993).

a/ As part of the general commitments undertaken by members on the avoidance of restrictions on current transactions under article VIII of the IMF Articles of Agreement.

Figure 3. Temporary restrictions on current transactions,
including repatriation of earnings, ^{a/} 1973-1993

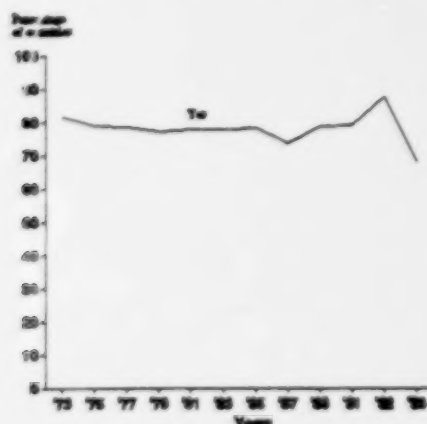


Source: International Monetary Fund, Exchange Arrangements and Exchange Restrictions, Annual Report (Washington, D.C., IMF, 1973 through 1993).

^{a/} Within the exceptions allowed by the IMF Agreement for balance-of-payments considerations.

57. Most countries continue to screen capital movements through direct controls administered by the monetary authority. Transfers over a given amount may require the central bank's prior approval. In the event of a balance-of-payments crisis, the central bank may even withhold permission for overseas payments for an unspecified period (figure 4). There are also various restrictions affecting short term-capital movements. In addition, many countries continue to impose taxes on the remittance of profits, dividends and capital. These fiscal instruments are meant to stimulate reinvestment of profits in the host country. But outright obligations of reinvestment of profits, which were used in the past by developing countries, seem to have been discontinued.

Figure 4. Restrictions on capital transactions, 1973-1993



Source: International Monetary Fund, Exchange Arrangements and Exchange Restrictions, Annual Report (Washington, D.C., IMF, 1973 through 1993).

9. A summary appraisal

58. The wave of liberalization measures in the 1980s and 1990s has changed considerably investment regimes in today's world. The most important changes have taken place in the following areas:

(a) The number of industries and activities closed or restricted to FDI has been considerably reduced;

(b) Compulsory joint ventures with Government or local private participation are now limited to a small number of "strategic" activities in a few countries;

(c) Fade-out requirements have virtually disappeared;

(d) The requirement of authorization for entry and establishment for all FDI has been generally eliminated and replaced by registration, mainly to facilitate the repatriation of capital and remittances of profits and other current payments. In some industries (e.g., banking), of course, authorization requirements remain, often in the context of such requirements for both foreign and domestic firms;

(e) Certain performance requirements have now been prohibited, while others have become more focused and tend to be voluntary, required mainly in return for incentives;

(f) While exchange controls are still in effect in many countries, there are indications that they are administered in a more liberal fashion with respect to the remittances of profits and the repatriation of capital of registered investments;

(g) The principles of non-discrimination and national treatment are gaining acceptance and are in fact recognized in the basic laws of many countries or as part of international commitments;

(h) Internationally acceptable standards of legal protection for foreign investors, particularly in the areas of expropriation, state contracts and settlement of disputes, are now guaranteed by the State in many countries, as part of their national legislation and increasingly through international commitments;

(i) Many Governments have taken steps to publicize and disseminate their laws and regulations on FDI, increasing in this manner the transparency of their regulatory frameworks;

(j) A number of countries have adopted or are strengthening their antitrust laws, and health, safety, consumer and environmental standards, and have established mechanisms to supervise international mergers and acquisitions, stock exchanges and financial markets.

59. A more accurate and detailed picture of the status of the liberalization process would have to be reached through a sectoral analysis of its operation.

While certain broad uniformities obtain, the limits, the needs and the possibilities of liberalization differ in each of the major economic sectors. 14/

III. BEYOND LIBERALIZATION

60. The basic elements of the liberalization process reviewed above, namely, the elimination of restrictions and discrimination, adherence to certain positive standards and the establishment of controls and prudential supervision to ensure the proper functioning of the market, are central, immediate and direct aspects of the policy and normative framework for FDI and TNC operations. Yet, the broader context within which foreign affiliates operate inside a host country is also relevant and, as the liberalization process progresses, becomes increasingly visible. Certain aspects of the internal normative framework are essential to give meaning and effect to that process. This applies, in particular, to the broader regulatory and administrative framework and the investment climate in general.

(a) The effectiveness of the liberalization process, including the operation of controls to ensure its proper functioning, depends on the existence of a reasonably comprehensive legal framework for business activities in general, including, for example, appropriate legislation on companies, industrial relations and insolvency. In fact, a properly functioning legal order, including well functioning courts, is required to provide predictability and certainty, including, for instance, respect for such basic principles as due process of law. Furthermore, reasonably well functioning administrative infrastructures are necessary to ensure the effective implementation of the legal framework within which business operates. In the absence of a reasonably complete framework and legal order, a case-by-case treatment of investments and enterprises would be necessary. In a country lacking adequate legislation on the exploitation of natural resources, for instance, each "concession" to a prospective investor would be fashioned on the basis of the State's needs at the moment, short-run conditions in the relevant market, the investor's ability to persuade local officials and other factors. The result may be a situation in which different investors in the same industry operate under different rules negotiated by contract. Subsequent investors typically try to improve on previous ones. The experience in many developing countries rich in natural resources has shown clearly the dangers of such a situation. Regardless of intentions, or fairness of approach, case-by-case treatment does not provide adequate predictability to investors and has in itself the potential for arbitrary action and for restrictions of various kinds. In such a situation, moreover, such fundamental facets of a liberalized regime as the grant of national treatment can have no precise meaning and function. Liberalization is a fragile process that needs the support of a sturdy legal framework to survive;

(b) Furthermore, this is only part of what constitutes a good investment climate. Of course, certain issues like political and economic stability may not be under a government's immediate control. Similarly, the establishment of a sound macroeconomic framework, the upgrading of a country's human resources and the strengthening of its physical infrastructure may require some time. But there are a number of measures a government can take, where appropriate, with an

immediate effect on the investment climate. For example, entering into bilateral or multilateral commitments to guarantee foreign investors against non-commercial risks may boost investors' confidence. Also, a variety of promotional efforts can be undertaken to attract investment. Apart from their intrinsic value, promotion measures send positive signs of the "good will" of the host country towards foreign investors and, therefore, constitute important ingredients of a favourable investment climate. The same effects can be obtained from a positive attitude of the governments to the private sector (both domestic and foreign) which, among other things, can find its expression in privatization programmes.

61. Overall, the liberalization of FDI regimes and the provision of a favourable investment climate do not imply a weakening of the role of government, but rather a redefinition of some of its functions and the strengthening of others. In particular, the processes of reducing restrictions and establishing positive standards occur simultaneously with the introduction or strengthening of controls aimed at ensuring the proper functioning of markets. Finally, and recalling the relative character of liberalization and the fact that there are more and less liberalized regimes, it must be stressed that a description or even an analysis of the liberalization process cannot involve a quest for perfection. It would be difficult to define in clear terms what constitutes a perfect investment regime, in terms of liberalization, even from the viewpoint of a single investor, and even more so if one had to take into account the interests of other investors, domestic as well as foreign, and the long-term interests of the countries concerned. The liberalization process is a policy process; and, like all such processes, it involves difficult choices between desirable outcomes and trade-offs between objectives. Any discussion must accept that it necessarily involves trends and patterns, and moves in areas of approximation and uncertainty.

IV. CONCLUSIONS

62. While the process of liberalization has led to a certain convergence of the characteristics of FDI regimes, numerous - and at times considerable - differences, of course, remain. With the increasing internationalization of the domestic policy agenda (Ostry, 1992) due to the greater integration of the world economy at the level of production, these differences assume greater importance than in the past. Investment policies in one country can and do influence events in other countries and, in any case, the experiences gained with FDI in one country are of potential interest to decision makers in other countries. Exchanges of information on FDI become, therefore, more important than they were in the past.

63. The most important basic effect of such exchanges of information is to increase transparency. Increased transparency has a number of benefits for the world economy, home and host countries and for TNCs. Given the interlinkages between FDI, trade and technology, FDI matters are increasingly becoming part of international discussions on trade and technology, as witnessed, for instance, by the negotiations of the Uruguay Round and NAFTA; exchanges of experiences can help policy makers to deal more effectively with these interrelationships.

64. For Governments, the exchange of information about the normative frameworks that govern FDI in their countries is beneficial because it allows them to learn from the experiences - and especially best practices - elsewhere. At the same time, greater transparency of the investment framework facilitates the decision-making process of TNCs, especially small- and medium-size enterprises and those from developing countries that have limited in-house capacities to obtain relevant information.

65. The effectiveness of the exchanges that have already been undertaken could benefit from more structured preparations and more systematic discussions and the participation of interested private sectors. The Commission may wish to consider whether this is, indeed, an objective worthwhile pursuing and, if so, how it could be done most effectively.

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Notes

1/ See UNCTAD, Report of the Ad-Hoc Working Group on Comparative Experiences with Privatization on its Third Session (TD/B/40(2)/5).

2/ See UNCTAD, Report of the Ad-Hoc Working Group on the Interrelationship between Investment and Technology Transfer on its Second Session (TD/B/40(2)/10).

3/ See "Case study submitted by the Netherlands" (TD/B/WG.1/Misc.3); "Case study submitted by the Republic of Korea" (TD/B/WG.1/Misc.3/Add.2); and "Case study submitted by the United States of America" (TD/B/WG.1/Misc.3/Add.7).

4/ See "Case study submitted by Brazil" (TD/B/WG.1/Misc.3/Add.6); "Case study submitted by China" (TD/B/WG.1/Misc.3/Add.5); "Case study submitted by India" (TD/B/WG.1/Misc.3/Add.3); "Case study submitted by Mexico" (TD/B/WG.1/Misc.3/Add.1); "Case study submitted by Morocco" (TD/B/WG.1/Misc.3/Add.8); "Case study submitted by Myanmar" (TD/B/WG.1/Misc.3/Add.10); "Case study submitted by Nigeria" (TD/B/WG.1/Misc.3/Add.9); and "Case study submitted by the Philippines" (TD/B/WG.1/Misc.3/Add.4).

5/ For more details, see the reports of the Ad Hoc Working Group on Investment and Financial Flows, first session (TD/B/39(2)/6); second session (TD/B/40(1)/12); and third session (TD/B/40(2)/12).

6/ See UNCTAD, "Host country policies and measures to promote foreign investment: a synthesis of eight case studies", TD/B/WG.1/10, 25 October 1993.

7/ Foreign direct investment - the focus of this report - is defined as investment, including both equity and non-equity arrangements, that involves a long-term relationship reflecting a lasting interest of a resident entity in one economy (direct investor) in an entity resident in an economy other than that of the investor. The direct investor's purpose is to exert a significant degree of influence over the management of the enterprise resident in the other economy. A foreign-resident affiliate (thereafter "foreign-affiliate") of a TNC may be an enterprise incorporated in the host country (a subsidiary or associate company) or an unincorporated branch. See the definitions of FDI prepared by the OECD and the IMF; OECD, Detailed Benchmark Definition, Report Prepared by the Group of Financial Statisticians at the Request of the Committee on International Investment and Multinational Enterprises (Paris, OECD, 2nd Edition, 1992); IMF, Balance of Payment manual, Fifth Edition (Washington, D.C., IMF, 1993).

8/ It should be noted, however, that many countries started the liberalization process in the context of bilateral investment treaties and regional schemes; indeed, it is within the latter commitments that the highest levels of liberalization have been achieved. The liberalization process discussed here involves national measures as well as bilateral, regional and (when applicable) multilateral instruments.

9/ For a discussion of the relationships between the concepts of efficiency, development and liberalization, see UNCTAD, Programme on Transnational Corporations, and The World Bank, Liberalising International Transactions in Services: A Handbook (New York, United Nations, 1994).

10/ For an in-depth analysis of the various elements involved in the definition of the standard of national treatment see, UNCTC, Key Concepts in International Investment Arrangements and Their Relevance to Negotiations on International Transactions in Services, UNCTC Current Studies Series, Series A, No. 13 (United Nations publication, Sales No. E.90.II.A.3).

11/ See note 4.

12/ T. Andersson (Foreign Direct Investment in Competing Host Countries, A Study of Taxation and Nationalization, 1989) and St. Globerman ("Government policies towards foreign direct investment: has a new era dawned?", The Colombia Journal of World Business, 23 (1988), pp. 47-78), for instance, found some evidence of general relaxation of host country performance requirements already in the early 1980s.

13/ Article VIII of the International Monetary Fund's Articles of Agreement prescribes general obligations for Members with respect of the avoidance of restrictions on current payments, including remittances of profits, avoidance of discriminatory currency practices, convertibility of foreign-held balances, furnishing of information, consultation between members regarding existing international agreements, and collaboration regarding policies on reserve assets.

14/ For a detailed study of the characteristics of liberalization in the services sector, see UNCTAD, Programme on Transnational Corporations, and World Bank, Liberalizing International Transactions in Services, op. cit.
